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No. OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

October Term, 1994

CHARLES DAVIS, individually and on behalf of
all other similarly situated, Petitioner
v.
UNITED STATES OF AMERICA and
JESSE BROWN, Secretary of Veterans Affairs

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

A Department of Veterans Affairs ("VA") regulation governing its home loan guaranty program provides that a lender's release of the personal liability of any obligor, without the prior approval of the Secretary of Veterans Affairs, releases the obligation of the Secretary as guarantor of that obligation. The Court of Appeals held that informal acquiescence and encouragement by certain local VA employees of lenders' release of obligors constitutes "prior approval of the Secretary" notwithstanding the VA's issuance in each case of a timely, clear, unretracted, written instruction to the lender to preserve the personal liability of all obligors.

The question presented is whether the Court of Appeals holding permits an estoppel claim against the Federal Government for the payment of money not otherwise permitted by federal law, contrary to the Appropriations Clause of the Constitution.

LIST OF PARTIES

The caption contains the names of all parties to the proceedings below, except that of Edward Derwinski, who preceded Jesse Brown as Secretary of Veterans Affairs. The action was certified as a class action by the district court, and the class consists of an estimated 2,000 persons.

No parent or subsidiary company is required by Rule 29.1 of this Court to be listed.

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IN THE

Supreme Court of the United States

October Term, 1994

CHARLES DAVIS, individually and on behalf of
all other similarly situated, Petitioner
v.
UNITED STATES OF AMERICA and
JESSE BROWN, Secretary of Veterans Affairs

Petitioner Charles Davis, individually and as representative of a class of an estimated two thousand veterans, respectfully petitions this Court for issuance of a writ of certiorari to the United States Court of Appeals for the Seventh Circuit, and in support of this petition states as follows:

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit, of which petitioner seeks review, is reported at 34 F.3d 417. The opinion of the United States District Court for the Eastern District of Wisconsin, which was reviewed by the court of appeals, is reported at 815 F.Supp. 1202.

The opinion of the same Court of Appeals in a prior appeal in this action (including an order of that court denying a petition for rehearing) is reported at 961 F.2d 603. The opinion of the same District Court, which was reviewed by the Court of Appeals in that prior appeal, is reported at 756 F.Supp. 1162.

JURISDICTION

The judgment of the Court of Appeals, of which petitioner seeks review, was entered on August 24, 1994. A timely petition for rehearing was filed, and an order denying that petition was entered October 3, 1994. Petitioner invokes the jurisdiction of this Court under 28 U.S.C. sec. 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The pertinent provisions, the text of which appears in the Appendix at 133-149, are as follows:

Article I, Sec. 9, Clause 7 of the United States Constitution

38 U.S.C. sec. 501(a)

38 C.F.R. sec. 36.4317

38 C.F.R. sec. 36.4323(e)(first sentence)

38 C.F.R. sec. 36.4324(f)(2)

Sec. 846.04, Wis. Stats.

Sec. 846.10, Wis. Stats.

Sec. 846.101, Wis. Stats.

Sec. 846.165, Wis. Stats.

STATEMENT OF THE CASE

I. Introduction

In this action, a class of veterans and their dependents ("the veterans") contend that the VA has unlawfully collected and asserted indemnity claims for "deficiencies" arising from mortgage foreclosures under the VA's home loan guaranty program. In all cases, the guaranteed lender elected to foreclose its mortgage under a Wisconsin law that prohibits judgment for any deficiency remaining after the foreclosure sale, but the VA nonetheless paid the lender's claim for that deficiency, and then sought recovery over against the veteran.[1]

The case began when the United States sued Charles Davis, the petitioner herein, to collect such a deficiency. The District Court's jurisdiction over that complaint derived from 28 U.S.C. sec. 1345. Mr. Davis filed a responsive pleading denying liability, and at the same time filed a third-party class action complaint against the Administrator of the Veterans Administration (now known as Secretary of Veterans Affairs) for declaratory judgment, mandamus, injunctive relief to prohibit the VA from pursuing such indemnity claims, and for equitable restitution of amounts already collected by the VA in such claims. The District Court's jurisdiction over the third-party complaint derived from 28 U.S.C. secs. 1331, 1346(a)(2), 1361 and 1343(4); from 28 U.S.C. sec. 1820; and from that court's ancillary and pendent jurisdiction.

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[1] This petition uses the term "lender" for simplicity, although the party foreclosing might not be the original lender if that lender assigned the mortgage before foreclosure. *United States v. Davis*, 961 F.2d 603, 605 n.2 (7th Cir. 1992)("*Davis I*"), Appendix at 77.

The District Court adjudicated this action twice, each time on cross-motions for summary judgment. At no point in this litigation has there been any dispute of material fact. This case has nonetheless featured a variety of VA positions as to how it instructed lenders to foreclose guaranteed mortgages. In the District Court the VA originally asserted that it had in all cases "directed or approved" the election by lenders to waive the personal liability of obligors for deficiencies. On the basis of that assertion, this case appeared to be on all fours with *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir. 1990), *overruled in Carter v. Derwinski*, 987

F.2d 611 (9th Cir.), *cert. denied*, 114 S. Ct. 78 (1993). On the first appeal the VA asserted, to the contrary, that in at least some cases (including that of the named class representative) it had instructed the lenders to *preserve* the obligors' personal liability. That assertion distinguished this case, to that extent, from *Whitehead* and *Carter*; placed it, to that extent, on all fours with *United States v. Church*, 736 F.Supp. 1494 (N.D. Ind. 1990); and induced the Court of Appeals to remand for a determination of which veterans (the VA had already conceded there were some) were relieved of liability on the basis of *Church*. On remand the veterans demonstrated that the VA had instructed lenders to preserve the right to deficiency in the case of *every* class member. At that point the VA asserted for the first time a so-called "course of dealing" contrary to that universal instruction. The VA successfully relied upon that "course of dealing" on remand in the District Court and on the second appeal. The legal character and significance of that "course of dealing" is the key to this case.

II. Operation of the VA Home Loan Guaranty Program in Wisconsin

The VA operates a home loan guaranty program pursuant to Title III of the Servicemen's Readjustment Act of 1944, Pub. L. No. 346, 58 Stat. 291 (Subch. III, Ch. 37, T. 38, United States Code), and regulations promulgated thereunder.[2] An eligible veteran or veteran's widow or widower who wishes to participate in the program pays a fee to the VA, in exchange for which the VA guarantees payment of the loan to a private lender. 38 U.S.C. sec. 1829. Class members paid a fee of one percent of the total purchase price of the home.[3] Upon default by the borrower or by a subsequent purchaser of the home who has lawfully assumed the mortgage, the lender may foreclose the mortgage; any such foreclosure proceeds under state law. 38 U.S.C. secs. 1820(a)(6) and 1832; 38 C.F.R. secs. 36.4319 - 4320.

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[2] Amendments to the Servicemen's Readjustment Act have renumbered many of the statutory sections applicable in this case. Citations are to the statutes applicable here rather than as renumbered. *Davis I, supra* n.1, 961 F.2d at 605 n.1; Appendix at 76.

VA regulations provide that the lender must give the VA thirty days' notice before foreclosing (38 C.F.R. sec. 36.4317), and the VA has fifteen days from receipt of that notice in which to give the lender instructions as to the proceedings (38 C.F.R. sec. 36.4324(f)(2)). Specifically, the VA may "notify the holder [lender] . . . to proceed in such manner as to effectively preserve the personal liability of the parties liable, or such of them as the [VA] indicates in such notice to the holder . . . ." *Id.*

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[3] The fee has since been increased. Veterans' Benefit Amendments of 1989, H.R. 901, Pub. L. No. 101-237; Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, sec. 8032.

Such personal liability refers to a "deficiency" which, under Wisconsin law, is the difference between the amount due on a defaulted home loan after foreclosure (including costs incurred in the foreclosure process) and the net amount realized from the sale of the security for the loan (usually the home itself). Sec. 846.165, Wis. Stats. Wisconsin law provides that upon default of a home loan, where the borrower has so agreed in the mortgage instrument, the lender may elect to waive the right to a judgment against the borrower for any deficiency remaining after foreclosure. If the lender so elects, the period within which the borrower may redeem the mortgaged property is shortened from one year to six months. Sec. 846.101; *cf.* sec. 846.10(2). The election also relieves the lender from the obligation to obtain a finding by the state court that the sheriff sold the mortgaged premises for "fair value." *Cf.* sec. 846.165(2). Lenders who believe they are adequately secured, or who believe they are protected by a guaranty or other insurance, make this election in order to reduce the delay in recovering their security, which thereby reduces their risk and expense pending that recovery. *See Glover v. Marine Bank of Beaver Dam*, 117 Wis.2d 684, 345 N.W.2d 449, 454 (1984).

The VA promulgated a form of mortgage instrument for use in Wisconsin, in which the veteran gives the lender the option to reduce the redemption period by half, dispense with a finding of "fair value," and waive any deficiency. *See* R. 16, Exhibit B.[4] Upon the VA's receipt of a lender's notice of intent to foreclose a veteran's mortgage, the VA's uniform response was to send the lender a letter which approved the request to commence a foreclosure action, and instructed that "[i]n proceeding with such action, you should protect your rights against those liable, so as to protect our [the VA's] subrogated rights." R. 68, Ex. C at 2; R. 71 at

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[4] References in the form "R. __" are to the record in the Court of Appeals. The number refers to the item number in the District Court's docket sheet.

13; R. 83 at 4. (The letter to Mr. Davis' lender is reproduced at pages 129-130 of the Appendix.) In each case, the VA sent this letter before the lender commenced a foreclosure proceeding. R. 68, Ex. C at 3.[5] All lenders nevertheless elected to foreclose pursuant to sec. 846.101, Wis. Stats., and thereby waived personal liability of the veteran and any other obligors, along with the VA's subrogation rights. R. 83 at 2-3. On remand after the first appeal in this case, the VA filed affidavits of subordinate VA employees stationed in Wisconsin, as well as of several private attorneys who had prosecuted Wisconsin foreclosures of VA-guaranteed mortgages, which tend to show that those VA employees understood that lenders were generally waiving veterans' personal liability, and acquiesced in that conduct. R. 71 (Exhibits).

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[5] The VA's instruction letter is timely as long as the lender receives notice before it releases an obligor. *Western Securities v. Derwinski*, 937 F.2d 1276, 1281-82 (7th Cir. 1991). In Wisconsin, an obligor is not released until commencement of the foreclosure action. *See* sec. 846.101(1), Wis. Stats.

Typically, the lender is the only bidder at a foreclosure sale, and it "buys" the property by crediting its bid against the amount due on the loan. The VA directs the lender to bid the amount that the VA considers the property to be worth, even if that is less than the amount due. In each instance relevant to the cause at bar, the VA directed the lender to bid less than the amount of the obligation secured by the mortgage. R. 3, para. 3.4.8; R. 5, para. 3.4.8. The VA then paid the holder the difference, purportedly pursuant to the guaranty (R. 1, Ex. A), and in turn assessed and pursued the veteran for that amount plus interest (R. 3, paras. 3.4.9, 3.4.10(a); R. 5, paras. 3.4.9, 3.4.10(a)).

The VA has employed a variety of collection methods, including suing the veteran and obtaining a judgment against him in a federal district court (*id.*, para. 3.4.10(c));

recouping the amount of the claim (in part or in whole) from VA benefits due the veteran such as GI bill benefits, disability benefits, and widow's pension benefits (*id.*, para. 3.4.10(d)); setting off the amount of the claim from refunds owed the veteran by the IRS (*id.*, para. 3.4.10(e)); and accepting funds offered by the veteran in response to demands for payment or threats to take collection action (*id.*, para. 3.4.10(i)).

III. The Named Class Representative

Charles Davis is a veteran of the United States Navy. He served between 1970 and 1973, and received an honorable discharge. The VA seeks from him an alleged deficiency of $24,906.27 plus $2.34 per day after July 23, 1990.

Mr. Davis and his wife Elizabeth purchased a home in Oak Creek, Wisconsin, on August 27, 1980, under a VA guaranty. On that date, Mr. and Mrs. Davis executed a mortgage note and mortgage to Suburban Coastal Corporation, a New Jersey corporation, in the amount of

$61,000.00. When Mr. Davis' employer subsequently eliminated all overtime work, he and his wife were unable to make the monthly mortgage payments, and on September 9, 1985, the lender filed a foreclosure action in Milwaukee County Circuit Court. In its complaint, the lender specifically elected to proceed under section 846.101, Wis. Stats., and to be bound by the provisions thereof (R. 18, Ex. E1).

Judgment of foreclosure was entered on November 4, 1985. That judgment authorized sale of the Davis' home at public auction at any time after six months from the entry of judgment. The sale was conducted on May 5, 1986, and the property sold to the mortgage holder for $48,700.00. The sale was confirmed on May 19, 1986, and the VA subsequently pursued Mr. Davis for the deficiency. Mr. Davis formally requested the VA to waive that claim, but his request was denied. The VA intercepted the Davis' 1987 federal income tax refund in the approximate amount of $400.00, and their 1988 federal income tax refund of more than $1,000.00. Finally, on January 22, 1990, the United States filed this action seeking the balance of the alleged deficiency. *See generally* R. 16.

IV. Disposition in the Courts Below

On January 22, 1991, the District Court filed its decision and order on cross-motions for summary judgment and Mr. Davis' motion for class certification. R. 36; 756 F.Supp. 1162; Appendix at 15-52. That decision certified the class and held that the VA had unlawfully collected or asserted indemnity claims against most class members. The District Court found the facts of this case indistinguishable from those in *United States v. Shimer*, 367 U.S. 374 (1961), but concluded that *Shimer* does not control because "the federal regulations provide the VA with the power, whether or not it chooses to exercise it, to direct the lender to foreclose in a manner which preserves the lender's and the VA's right to a deficiency." It found no indication that this Court in *Shimer* had "ever considered or intended" that the

VA could obtain the benefits of an expedited foreclosure proceeding under state law without having to incur its costs. The District Court found that such a result is "inequitable and directly contravenes the intent of the Wisconsin foreclosure laws," and concluded that "if the Supreme Court were to consider this result, then it would limit its *Shimer* decision." The District Court held "that the VA is estopped from seeking a deficiency judgment against a veteran under its indemnity agreement when the lender forecloses against the veteran pursuant to Wis. Stat. sec. 846.101." 756 F.Supp. at 1168; Appendix at 36. Accordingly, the district court enjoined the VA from further collection of such claims and ordered a refund of amounts previously collected.[6]

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[6] On May 31, 1991, the District Court filed a decision and order that *inter alia*, dismissed the claims of veterans against whom the VA had obtained a final judgment on a deficiency claim in a court of record. R. 51 at 3-8; Appendix at 53-70.

The VA filed an interlocutory appeal of the injunction order. In a decision filed April 3, 1992, the Court of Appeals held that *Shimer* controls this case, and therefore that "the VA may exercise its federal indemnity right to seek reimbursement from veterans for guaranty obligations which it was legally obligated to pay, and did pay, lenders." *Davis I, supra* n.1, 961 F.2d at 608; Appendix at 88. The court found no grounds for estopping the VA from asserting its indemnity rights, or for limiting *Shimer*. 961 F.2d at 609-11; Appendix at 89-98. However, the Court of Appeals also held that "[i]f the VA pays lenders ... despite the lack of any legal obligation to do so, the payment is 'gratuitous' and the VA is not entitled to indemnification." *Id.* at 611, *citing United States v. Church, supra* p. 6, 736 F.Supp. at 1497-98; Appendix at 99. The court noted the VA's agreement with that rule, and its concession that a remand was necessary to determine which guaranty payments the VA was legally obligated to make; only those payments would trigger indemnity liability of the veterans. 961 F.2d at 611; Appendix at 99-100. Accordingly, the Court of Appeals reversed the district court's injunction order and remanded for "a determination of whether part of the ... class may be relieved of liability on the authority of *United States v. Church* . . . ." 961 F.2d at 611; Appendix at 102.[7]

On remand, the parties again filed cross-motions for summary judgment. The District Court, in a decision and order filed March 17, 1993 (R. 83; 815 F.Supp. 1202; Appendix at 105-120), found that the VA had in all cases issued timely written instructions to its lenders not to release veterans' personal liability (815 F.Supp. at 1203; Appendix at 109-110), but had also engaged in a contrary "course of dealing" with the lenders, whereby the VA acquiesced in release of such liability (815 F.Supp. at 1205; Appendix at 115-116). The District Court held that this "course of dealing" constitutes "prior approval of the Secretary" to release of veterans' personal liability as required by the applicable VA regulation (38 C.F.R. sec. 36.4324(f)). 815 F.Supp. at 1205; Appendix at 117. The court also distinguished *United States v. Church, supra* p. 6, on the ground that the VA in that case had issued a second written instruction which renewed its demand to preserve the veteran's personal liability. 815 F.Supp. at 1206; Appendix at 118-119. Accordingly, the District Court granted summary judgment in favor of the VA, and directed the entry of judgment against Mr. Davis on the indemnity claim. 815 F.Supp. at 1206; Appendix at 119. That judgment was entered on June 16, 1993. R. 91, Appendix at 123-124. The veterans timely moved to alter or amend the judgment pursuant to Fed. Rule Civ. Pro. 59(e), 28 U.S.C. (R. 92), and the District Court denied that motion on July 28, 1993 (R. 96, Appendix at 125-126).

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[7] Shortly prior to the Court of Appeals decision, the veterans moved to dismiss the appeal as moot on the basis of their discovery that the VA had instructed lenders to preserve the right to deficiency in the cases of *all* class members, thereby mooting the issue before that court, which was premised on the assumption that the VA had instructed the lenders to the contrary. The panel did not become aware of that motion until shortly after its decision, and responded to the motion by reiterating its remand order. 961 F.2d at 611; Appendix at 101-104.

The veterans appealed, and the Court of Appeals affirmed. *United States v. Davis*, 34 F.3d 417 (7th Cir. 1994)("*Davis II*"); Appendix at 1-14. That court distinguished *Church*, not on the ground discussed by the District Court, but because the court in *Church* did not consider the VA's "course of dealing." 34 F.3d at 420; Appendix at 10. The Court of Appeals further held that the "course of dealing" could constitute "prior approval of the Secretary" under the applicable regulation (38 C.F.R. sec. 36.4324(f)), even though the "course of dealing" was "blanket" in nature rather than case-specific, and even though it was not in writing over the signature of a designated VA official, as required by the VA's own policies and procedures manual. 34 F.3d at 420; Appendix at 11-12. Finally, the court concluded that if a lender sued the VA on a guaranty contract under the present facts, "the VA would still be bound to fulfill its guaranty obligation under its agreement with the lenders." 34 F.3d at 420; Appendix at 13-14.

V. The Class

The class is defined as all veterans or widows of veterans or other individuals eligible for home loan guarantees or insurance provided pursuant to Title 38, United States Code, Chapter 37, against whom a claim has been or will be made by the United States, pursuant to 38 C.F.R. 36.4323(e) or pursuant to a written indemnity agreement, which claim arose or will arise because of a claim paid by the United States to a lender which submitted such claim to the United States as a result of a foreclosure conducted in the State of Wisconsin, in which the lender elected and was permitted to waive deficiency and accelerate the redemption period pursuant to sec. 846.101, Wis. Stats., but excluding any claims based upon foreclosure of mortgages executed after

December 31, 1989.[8] R. 91 at 2. This class includes the following subclasses: (1) those against whom a final judgment on a deficiency claim has been entered in a court of record (*see* note 6, *supra*), and (2) those from whom the VA has collected all or a portion of a deficiency claim, without having obtained a final judgment.

REASONS FOR GRANTING THE PETITION

I. Summary of Argument

Analysis of the applicable regulation (38 C.F.R. sec. 36.4324(f)) reveals that the VA's uniform issuance of an unambiguous, unretracted instruction to *preserve* personal liability--i.e., the right to deficiency--logically precludes the possibility that the lenders had obtained prior approval of their release of such liability. Analysis of the undisputed facts, as well as the VA's conduct in this and other litigation, demonstrates that the VA itself has obviously never considered the "course of dealing" to constitute the Secretary's prior approval of a lender's release of personal liability under that regulation. The arguments advanced by the VA and the Court of Appeals equating the so-called "course of dealing" with "prior approval of the Secretary" are patently untenable.

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[8] In the case of a mortgage executed after December 31, 1989, the VA may not collect a deficiency from the veteran except in the case of fraud, misrepresentation or bad faith in obtaining the loan or in connection with the default. Veterans' Benefits Amendments of 1989, *supra* n. 3. *See* discussion *infra* at 61-62.

The real premise of the VA's argument and the Court of Appeals holding is implicit but nonetheless unmistakable: that the VA may be estopped by its "course of dealing"--i.e., the informal understandings between lenders and subordinate VA employees--from enforcing the regulation so as to be released from its guaranty. Since this case is the mirror image of a lender's action against the VA on a guaranty contract, the party implicitly asserting the estoppel in this case is not the Government's opponent but the Government itself. However, if the Government may rely upon an estoppel theory to establish its indemnity claim to recover money that it paid gratuitously to someone else, then claimants against the Government may also employ that theory to force Government payments that are otherwise prohibited by law.

This Court should grant this petition and reverse the decision of the Court of Appeals for the following reasons:

1. The Court of Appeals holding conflicts with this Court's decisions, and in particular *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990), that prohibit an estoppel claim against the Federal Government so as to entitle a claimant to a payment from public funds that lacks Congressional authorization. Application or endorsement of estoppel against the Government under these circumstances contravenes the Appropriations Clause of the Constitution, Art. I., Sec. 9, Cl. 7.

2. The Court of Appeals decision illustrates that lower courts continue to need more definitive guidance from

this Court regarding the circumstances, if any, in which the Federal Government may be estopped from enforcing the law. In recent years this Court has repeatedly left the door open to the possibility of estoppel of the Government in some limited circumstances. This approach has resulted in inadequate guidance for the federal courts and has proliferated litigation on this issue, as the Court itself has recognized. The Court of Appeals in this case has endorsed the concept of estoppel against the Federal Government when the Government itself, in a derivative claim for recovery over in indemnity, retrospectively acknowledges that it was estopped to enforce the law. This Court should close the door on estoppel claims against the Federal Government, perhaps entirely (as the Government itself has repeatedly urged this Court to do), but at least to the extent of holding that the Government may not rely upon such estoppel derivatively in a case where the recipient of public funds could not have relied upon the theory in an action on the underlying guaranty contract.

3. The Court of Appeals decision entails grave and widespread consequences for administration of numerous Federal Government programs affecting virtually the entire public. The prospect of estoppel claims against the Federal Government threatens the integrity of the Public Treasury by subjecting public expenditures to the individual predilection of subordinate Government agents and the citizens with whom they deal, rather than to the will of Congress. Virtually the entire public interacts, in one way and at one time or another, with one or more Federal Government programs pursuant to which public funds are disbursed according to rules established by Congress, or by agencies pursuant rulemaking powers delegated by Congress. Inherent in each such interaction is the possibility of a real or imagined "understanding" between a Government employee and potential recipient of public funds that contravenes the

requirements of law for disbursement of those funds. Moreover, many Federal Government loan programs besides the VA home loan guaranty program contemplate Government guaranties of private financial obligations, and provide for the Government's "recovery over" from program beneficiaries of funds it is obligated to pay to guaranteed parties. Uncertainty regarding the extent (if any) to which guaranty claimants may directly assert estoppel against the Government, as well as the extent (if any) to which the Government itself may rely on such a theory in its attempts to recover in indemnity or subrogation for unauthorized guaranty payments, substantially affects the operation of such programs. Finally, ongoing collection of indemnity claims arising from unauthorized guaranty payments by the VA alone affects many thousands of veterans nationwide.

II. Argument

A. The Court of Appeals' holding unlawfully permits a claim of estoppel against the Federal Government for the payment of money not otherwise permitted by federal law.

In *Davis II*, the Court of Appeals reiterated the rule that when the VA pays a lender's guaranty claim despite the lack of any legal obligation to do so, the VA is not entitled to indemnification from the veteran for such a gratuitous payment. *Davis II, supra* p. 20, 34 F.3d at 419, *citing with approval Davis I, supra* n.1, 961 F.2d at 611, and *United States v. Church, supra* p. 6, 736 F. Supp. at 1497-98; Appendix at 6. Indeed, this Court in *Shimer* recognized the same rule:

> a well-established principle of surety law which both parties agree was recognized by Congress when it passed Title III [of the Servicemen's Readjustment Act of 1944]: The Veterans' Administration, as guarantor, could not recover from its principal, Shimer, any amount it was not obligated to pay the mortgagee, Excelsior, on his behalf.

United States v. Shimer, supra p. 15, 367 U.S. at 376-77.

When the lender has released an obligor's personal liability, the VA's legal obligation to pay the lender's guaranty claim is measured by 38 C.F.R. sec. 36.4324(f). This regulation, promulgated by the VA pursuant to its rulemaking authority under 38 U.S.C. sec. 501(a), is of legislative effect, and must be given controlling weight by courts absent demonstration that it is arbitrary, capricious or manifestly contrary to statutory authority. *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984). The regulation generally requires "prior approval of the [VA] Secretary" of such a release. An exception applies when the release of an obligor's personal liability occurs by virtue of election of remedy in a foreclosure action: in that event, prior approval of the Secretary is unnecessary if the lender gives the VA thirty days' notice of intent to foreclose, and the VA fails timely to instruct the lender to preserve the personal liability of the obligor.

Absent prior approval of the Secretary or satisfaction of the conditions set forth in the foreclosure exception (or other exception in the regulation),[9] the lender's release of the obligor also releases the VA from its guaranty.

The Court of Appeals held that the exception in the regulation never came into play, because the so-called "course of dealing" constitutes the required prior approval of the Secretary. 34 F.3d at 420; Appendix at 11-12. That holding conflicts with the undisputed fact that in the case of each veteran, the VA issued a timely, written and unambiguous instruction not to release personal liability in the foreclosure. As the VA itself conceded in the Court of Appeals, such an instruction is contemplated by the applicable regulation "only where there has been no prior approval." VA Br. at 19 (*Davis II*). There would be no reason for the VA to issue such an instruction if it had given effective prior approval of the contrary procedure. Therefore, unless that instruction was mistaken, withdrawn or countermanded, its existence logically precludes the existence of prior approval.

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[9] The other exceptions to the requirement of "prior approval of the Secretary" in 38 C.F.R. sec. 36.4324(f) are not pertinent to this case.

The VA did not argue and the Court of Appeals did not find that the VA *mistakenly* issued its instruction letter --i.e., that the authors of the letters were unaware of the "course of dealing" now claimed to constitute prior approval under the regulation. Indeed, the letter to Charles Davis' lender, as well as to many other lenders, was signed by Diane B. Wojculis, one of the VA employees whose affidavits on remand in the District Court establish the "course of dealing." R. 68, Ex. B; R. 71, A6. Thus the VA's uniform practice of issuing the instruction letter, hundreds of times over a period of years, was not an oversight but was a reflection of its knowledge that the lenders had not obtained approval for release of personal liability.

The VA did not argue and the Court of Appeals did not find that the VA's instruction to preserve personal liability was withdrawn or countermanded. Nor is there record evidence to support such a finding. The VA's affidavits on remand establish that certain local VA officials knew of the lenders' practice of waiving personal liability, acquiesced in it, encouraged it, and did not *verbally* instruct lenders to the contrary. The VA's evidence stops conspicuously short of establishing that its employees verbally instructed lenders to waive personal liability. *See* District Court opn., 815 F.Supp. at 1204-05; Appendix at 112-113. The District Court concluded: "[T]he VA . . . knew and acquiesced, if not verbally directed, the lenders to foreclose pursuant to sec. 846.101[, Wis. Stats.]" 815 F.Supp. at 1205; Appendix at 115-116. Hence the VA's use of the term "course of dealing," and not "retraction" or "countermand."[10]

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[10] The most definitive statement of the "course of dealing" is found in a letter from one of the lenders' attorneys (Terry Gray) to Tom Bitters, the VA's district counsel: "[u]nless you instruct us to the contrary on a specific case, we will waive your right to a deficiency judgment against the defendants in order to obtain the shortest possible

Throughout its opinion, the Court of Appeals referred to the VA's instruction letter as the "initial letter" (34 F.3d at 419; Appendix at 8) or the "earlier explicit written instructions" (34 F.3d at 420; Appendix at 13). These references incorrectly imply that in each case the VA first issued the letter contemplated by the regulation, and then advised the lender to ignore it. But as the court elsewhere recognized (34 F.3d at 420; Appendix at 11), the VA's acquiescence and encouragement was "blanket" in nature, not case-specific. At some point in time that cannot be ascertained with any precision, certain local VA officials understood in a general sense that lenders were waiving veterans' personal liability, and acquiesced generally in that conduct. The

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redemption period under Wisconsin law. As you know, the VA and the FHA do not object to such a waiver in Wisconsin." District Court opn., 815 F.Supp. at 1204 n.8, Appendix at 113. Of course, the VA did instruct to the contrary in the specific cases of each class member. Thus, the "course of dealing," as stated in Attorney Gray's letter, is not by its terms inconsistent with the plain meaning of the VA's instruction letter to preserve personal liability.

instruction letter, on the other hand, issued on a case-by-case basis when the lender indicated it was ready to foreclose. In those cases where the VA's instruction letter and commencement of the ensuing foreclosure *did* precede the establishment of that understanding and acquiescence, there was no *prior* approval to release of personal liability. In the rest of the cases the VA acted uniformly and on a case-specific basis to foreclose the exception to the requirement of prior approval under the regulation, notwithstanding that the "course of dealing" had been established. Under these circumstances the most that can be said of that "course of dealing" is that it co-existed with the explicit instruction letters, but certainly it did not withdraw or countermand any of those letters.

Instead of arguing that its clear instruction to preserve personal liability was mistaken, withdrawn or countermanded, the VA argued for a limiting construction of that instruction: specifically, that the letter applied only to the release of *non-veteran* obligors. VA Br. at 16 n.4 (*Davis II*). The District Court soundly rejected this argument (*see* 815 F.Supp. at 1203, Appendix at 110), and the Court of Appeals did not disagree (*see* 34 F.3d at 419; Appendix at 7). Rather, the Court of Appeals simply concluded, as did the District Court, that prior approval had been obtained *notwithstanding* the instruction to the contrary. This conclusion was informed by an artificial reading of the applicable regulation. While a lender need not rely upon the exception if it has already obtained prior approval, the Court of Appeals ignored the reality that the VA's issuance of an instruction plainly *negating* the exception necessarily entails the absence of prior approval under the regulation's general rule.

The argument for prior approval by "course of dealing" would be better if a lender had not notified the VA of its intent to foreclose and therefore had not received any foreclosure instructions from the VA. Then one could argue that the lender relied on the "course of dealing" as the prior approval, and thus it had not been necessary to invoke the exception. But such an argument is completely untenable where the VA did instruct the lender, pursuant to the regulation and in unmistakable terms, to preserve personal liability. The Court of Appeals, like the lenders, completely ignored the legal and logical consequences of the VA's issuance of this instruction.

This truth may not be altered by characterizing as a "factual finding" the district court's determination that the "course of dealing" constituted prior approval under the regulation. *See* 34 F.3d at 420; Appendix at 12. That is not a factual finding; it is a conclusion of law. The facts, which are undisputed (*see* District Court opn., 815 F.Supp. at 1205; Appendix at 111-113, 115), are that certain subordinate VA employees informally acquiesced in and encouraged the lenders' practice of releasing personal liability in foreclosure actions. The issue of law which separates the parties is whether such a "course of dealing" constitutes the prior approval contemplated by the regulation, or simply laxity on the part of public employees.

The VA's uniform response to each lender's notice of intent to foreclose, with a specific, written, timely and unambiguous instruction to preserve personal liability, demonstrates unequivocally that the VA did not believe the Secretary or his authorized delegate had given prior approval of the contrary course of conduct. Nor can the VA credibly assert that a mere "course of dealing" serves as prior approval, in the face of the VA's own policy and procedures manual extant during the relevant time period. That manual clearly specifies the only permissible form of prior approval under the applicable regulation: in writing and over the signature of a VA official authorized to act for the Secretary. Manual M26-4, Revised: *Loan Guaranty Operations for Regional Offices - Claims and Liquidation Policies and Procedures*, sec. 2.07c (R. 71, A1, para. 7 and E7).

Contrary to the Court of Appeals' observation, the relevance of this crystal clear internal policy is not to determine whether the VA had a particular "course of dealing" (34 F.3d at 420; Appendix at 12), but rather to demonstrate that the VA's present position regarding the legal significance of the "course of dealing" is not bona fide.

The VA's knowledge that it had not given prior approval to release of personal liability is also clearly reflected in its posture in other litigation on the subject. *United States v. Church, supra* p. 6, involved a Wisconsin foreclosure that occurred during the time period relevant to the cause at bar. The veteran there, like the veterans here, argued that the VA had paid the lender gratuitously because the lender had contravened the VA's letter instructing it to preserve personal liability of all obligors--the precise letter which issued in the case of every class member here. *See* Appendix at 129-132. In response to the veteran's assertion in *Church*, the VA breathed not a word about the so-called "course of dealing," either initially *or* in its petition for rehearing. This is strange given the all-pervasive and prominent nature of the "course of dealing" which the VA alleges in the cause at bar.

Perhaps stranger still, in light of the VA's "course of dealing" argument, is the agency's position in *Western Securities v. Derwinski*, *supra* n.5. In that case, the VA refused payment of a lender's guaranty claim, because the lender had released an obligor despite the VA's issuance of a written instruction that was functionally equivalent to the written instruction to each guaranteed lender in the cause at bar. In *Western Securities*, the lender did not mention a "course of dealing," even though the lender was represented by one of the law firms that contributed an affidavit in support of the "course of dealing" in the cause at bar. Even more importantly, the VA could not in good conscience have taken the position it took in *Western Securities* if it had believed that the "course of dealing" satisfied the regulation's requirement of prior approval of the Secretary. Yet the Court of Appeals did not so much as mention *Western Securities*.

Finally, consider the VA's litigation posture before this Court's remand in the previous appeal. In the VA's first brief in the District Court, it stated: "Indeed, in this case, the lender chose to foreclosure [sic] without obtaining a deficiency judgment despite the VA's request to the contrary." R. 18 at 16. Later in the same brief, the VA said:

> While *Whitehead* found that the VA in that case "actively participated in what is, in effect, a choice of remedy under Washington law," that certainly was not the case with respect to defendant Charles Davis, nor does [the] VA routinely do so in Wisconsin. Indeed, as noted in the factual section of this brief, the VA i[n] this case expressly requested the lender by form letter to proceed in a manner "so as to protect our [the VA's] subrogated rights."

Id. at 29. On the day before oral argument in the District Court on the first set of cross-motions for summary judgment, the VA moved for permission to amend its answer to the third-party complaint, stating that "subsequent research, including the facts of Davis' case, reveal that the VA has not in all cases 'directed or approved' the use of such a foreclosure procedure [waiving the veteran's personal liability]." R. 33 at 2. Finally, at oral argument before the Court of Appeals in *Davis I,* the VA's extremely able counsel responded as follows to the court's question regarding the need to remand on the *Church* issue:

> At this point there is an indication that a significant number of veterans would be able to obtain relief on those grounds. Exactly how substantial the percentage is we don't know. It appears also that the named [third-party] plaintiff may well be one of those individuals. So we certainly do concede that a significant number of the veterans involved in this case would be able to prevail even if our position on the broader legal issue is accepted.

R. 74, para. 2 and Ex. A.

These assertions of the VA, prior to its realization that it timely issued the same clear instruction letter in the case of every class member, are the *truth.* In the face of these consistent and voluminous indications that the VA has never considered its "course of dealing" to be the prior approval contemplated by the regulation, it is simply unrealistic to pretend that the VA suddenly discovered new evidence to save the day on remand. The VA's current litigation posture is nothing more or less than what it appears to be: an expedient flip-flop. While perhaps the VA may not be judicially estopped from talking out of both sides of its mouth, this Court should certainly recognize that the VA is doing just that.

When the "course of dealing" is thus stripped of the false grandeur in which the VA clothed and the courts below beheld it, it may be seen exactly for what it is: informal acquiescence and encouragement of lenders by certain local VA officials in a course of conduct not permitted by federal law (38 C.F.R. sec. 36.4324(f))--i.e., releasing personal liability despite the VA's issuance of a contrary instruction pursuant to the regulation. *See Veterans Administration*

General Counsel Opinion No. 15-2a (November 7, 1977)(course of dealing by which VA paid private institution for vocational rehabilitation training, despite lack of legal authority to do so, did not preclude VA from recouping erroneous payments). When the "course of dealing" is seen for what it is, the holding of the Court of Appeals may be seen for what *it* is. The VA's indemnity claim was upheld on the sole and unmistakable (albeit implicit) basis that the VA was estopped by the conduct of its subordinate employees from enforcing its guaranty regulation, which resulted in guaranty payments to lenders from the Public Treasury that are not otherwise permitted by federal law.

The contract between the VA and a veteran, whereby the veteran agrees to indemnify the VA for payments the VA is obliged to make to a lender under a guaranty, transforms this action into the mirror image of a lender's action against the VA on a guaranty contract. Thus, the party asserting the estoppel in this case is not the Government's opponent but the Government itself! May the Government, in order to establish an indemnity claim to recover money it has already gratuitously paid to a third party, rely (however implicitly) on the theory that it (the Government) was estopped by the action or inaction of its agents from withholding that payment? If so, claimants against the Government may indeed assert estoppel against it under functionally equivalent facts, and thereby obtain Government payments otherwise prohibited by law: what's sauce for the goose is sauce for the gander.

The dispositive issue on each side of the mirror--the guaranty contract between the VA and the lender, and the indemnity contract between the VA and the veteran--is identical: whether the VA was legally obligated to pay the lender under the guaranty contract. The result in the action on the guaranty contract necessarily controls the result in the indemnity action. In a dispute between a lender and the VA on a guaranty contract, the lender's position would be that of the VA in this action, and the VA's position would be that of the veterans here. The essence of the lenders' case, colloquially speaking, would be: "Whadda ya mean you're not going to pay? We talked to Tom Bitters [VA Assistant District Counsel in Wisconsin] and he said it was perfectly okay to waive the right to a deficiency judgment; in fact he told us the VA prefers that!" The lenders, in support of their motion for summary judgment, would file the same affidavits of private attorneys as the VA filed in the instant cause. R. 71, A3 and A5. In addition, the lenders would extract, on adverse depositions, the same information from VA employees as is contained in their affidavits in the instant cause. *Id.*, A1, A2 and A6. The VA would assert that it was released from the guaranty on the basis of the lender's release of an obligor's personal liability despite the VA's timely, unmistakable and unretracted instruction to the contrary.[11]

The Court of Appeals expressly held that the lenders would win that action, and therefore that the veterans must lose here. No matter how that holding dressed up, it is a holding that the VA may be estopped from enforcing its regulation, so as to force a payment from the Public Treasury that is otherwise prohibited by law.

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[11] The VA has in fact defeated the claim of a lender under a guaranty agreement on the ground that the lender contravened a written instruction not to release personal liability. *Western Securities Co. v. Derwinski, supra* n.5. Since neither party in that case asserted a "course of dealing," the issue of its legal effect was not addressed. Rather, the lender litigated at the trial court level, and lost, the issue of whether the person released had in fact ever been an obligor; and it litigated in the Court of Appeals, and lost, the issue of whether the VA instruction was timely if it issued more than fifteen days after the VA's receipt of the notice of intent to foreclose but nonetheless prior to commencement of the foreclosure action. *See* 937 F.2d at 1281-1282.

B. The Court of Appeals holding conflicts with this Court's decisions prohibiting application of estoppel against the Federal Government so as to entitle a claimant to payment of money from the Public Treasury that is otherwise prohibited by law.

The decision of the Court of Appeals runs afoul of this Court's rulings in a line of cases, culminating with *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990), in which this Court has refused to entertain claims of estoppel against the Federal Government based upon the action or inaction of its agents, and in particular has held that the Appropriations Clause of the Constitution, Art. I, Sec. 9, Cl. 7, affirmatively prohibits estoppel of the Federal Government in a claim to public funds not otherwise permitted by federal law.[12]

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[12] The veterans' action for a refund of amounts unlawfully collected and retained by the VA does not implicate the Appropriations Clause. *See United States v. Testan*, 424 U.S. 392, 401-02 (1976); *United States v. Aiello*, 912 F.2d 4, 8 (2d Cir. 1990), *cert. denied*, 498 U.S. 1048 (1991).

In *Richmond*, this Court ruled that erroneous oral and written advice given by a federal employee concerning a claimant's eligibility for federal disability annuity payments, which induced the claimant to lose eligibility for a period of time, could not give rise to an estoppel so as to entitle the claimant to a monetary payment not otherwise permitted by federal law. 496 U.S. at 415-16. In its review of the history of estoppel claims against the Federal Government, this Court noted that "we have reversed every finding of estoppel we have reviewed" (*id.* at 422), and in particular that the "Court has never upheld an assertion of estoppel against the Government by a claimant seeking public funds" (*id.* at 434). The Court characterized as dictum the proposition that estoppel of the Government is *ever* permissible. *Id.* at 421.

The *Richmond* Court relied upon *Federal Crop Insurance Corporation v. Merrill*, 332 U.S. 380 (1947), which it characterized as "the leading case in our modern line of estoppel decisions." 496 U.S. at 420. In *Merrill*, an agent of the Government insurer erroneously advised a farmer that his entire crop qualified for insurance, and the error was not discovered until loss of the crop. This Court held that even the serious hardship caused by the agent's misinformation could not "provide a basis for ordering recovery contrary to the terms of the regulation, for to do so would disregard 'the duty of all courts to observe the conditions defined by Congress for charging the public treasury.'" *Id.*, quoting *Merrill*, 332 U.S. at 385-86. *Merrill* itself has roots deep in the history of this Court's jurisprudence: 125 years ago this Court held in *The Floyd Acceptances*, 7 Wall. 666, 19 L.Ed. 169 (1869), that the Government could not be compelled to honor bills of exchange issued by the Secretary of War where there was no statutory authority for issuance of the bills. *See Richmond*, 496 U.S. at 420.

Richmond squarely held that the Federal Government may not be estopped by a claimant seeking public funds. *Id.* at 434. This Court based that ruling upon the principle that the Appropriations Clause, which provides that the payment of money from the Federal Treasury must be authorized by a statute, bars the granting by equitable estoppel of a money remedy that Congress has not authorized. *See id.* at 424-26. *Richmond* made clear that this Court's long line of cases denying estoppel is animated by the same concerns--preventing fraud and corruption and, more fundamentally, assuring that public funds will be spent according to the judgments reached by Congress as to the common good--that prompted the inclusion of the Appropriations Clause in the Constitution *See id.* at 427-28. If agents of the executive branch could by means of unauthorized statements obligate the Treasury for the payment of funds, the control over public funds that the Appropriations Clause reposes in Congress in effect could be transferred to the Executive. *Id.* at 428. Moreover, to open the door to estoppel claims would invite endless litigation and might lead the Government to impose strict controls upon its provision of information, depriving the public of valuable informational programs. *See id.* at 433-35. This Court also noted the anomaly that would be entailed in judicially approving estoppel of the Government in a claim for public money, when Congress had specifically excluded misrepresentation (whether negligent or intentional) as a basis for recovery of money from the Government in the Federal Tort Claims Act (28 U.S.C. secs. 1346(b), 2671, et seq.); and in light of the fact that a Government employee who knowingly spends money in excess of that appropriated by Congress is subject to criminal penalties (31 U.S.C. secs. 1341, 1350). *See* 496 U.S. at 429-30.

In *Heckler v. Community Health Services of Crawford County, Inc.*, 467 U.S. 51, 60 (1984), this Court rejected a claim of estoppel against the Federal Government in a claim to prevent recoupment of Medicare reimbursement overpayments. This Court reasoned that estoppel against the Federal Government, assuming it is ever permissible, cannot be based on oral advice from a Government agent:

> It is not merely the possibility of fraud that undermines our confidence in the reliability of official action that is not confirmed or evidenced by a written instrument. Written advice, like a written judicial opinion, requires its author to reflect about the nature of the advice that is given to the citizen, and subjects that advice to the possibility of review, criticism, and reexamination. The necessity for ensuring that governmental agents stay within the lawful scope of their authority, and that those who seek public funds act with scrupulous exactitude, argues strongly for the conclusion that *an estoppel cannot be erected on the basis of the oral advice* that underlay respondent's cost reports.

467 U.S. at 65 (italics added). Thus, notwithstanding the Court of Appeals' conclusion that 38 C.F.R. sec. 36.4324(f) "itself does not require written approval" (34 F.3d at 420; Appendix at 12), a lender may not rely on oral "approval" to nullify a contrary written instruction that the VA *did* issue.

Indeed, in *United States v. Rossi*, 342 F.2d 505, 506-07 (9th Cir. 1965), where, as here, the VA sought to recover a deficiency from a veteran based on its indemnity contract, the court held that VA was not estopped by the alleged oral representation of a VA employee that the veteran would not be liable to the VA if he could dispose of the property. The court, citing *Federal Crop Insurance Corporation v. Merrill*, *supra* p. 48, stated: "Where an official of the United States acts outside his actual authority, the United States is not estopped by that action." 342 F.2d at 506-07. The VA's positions in *Rossi* and the cause at bar are fundamentally inconsistent. Moreover, the decision of the Court of Appeals in *Davis II*, which implicitly endorses a theory of judicial estoppel against the VA in order to uphold the VA's derivative indemnity claim, is fundamentally inconsistent with *Rossi,* as well as with this Court's teachings in respect to estoppel claims against the Federal Government.

C. The Court of Appeals decision illustrates that lower federal courts continue to need more definitive guidance from this Court regarding the circumstances, if any, in which the Federal Government may be estopped from enforcing the law.

Since *Montana v. Kennedy*, 366 U.S. 308, 314-15 (1961), this Court's opinions "have continued to mention the possibility, in the course of rejecting estoppel arguments, that some type of 'affirmative misconduct' might give rise to estoppel against the Government." *Richmond*, 496 U.S. at 421; *see INS v. Hibi*, 414 U.S. 5, 8 (1973)(*per curiam*); *Schweiker v. Hansen*, 450 U.S. 785, 788 (1981)(*per curiam*); *INS v. Miranda*, 459 U.S. 14, 19 (1982)(*per curiam*); *Heckler v. Community Health Services, supra* p. 51, 467 U.S. at 60. In *Richmond*, this Court noted that its dictum had "since taken on something of a life of its own" (496 U.S. at 421), and that "Courts of Appeals have taken our statements as an invitation to search for an appropriate case in which to apply estoppel against the Government" (*id.* at

422). This Court further observed that three of its most recent decisions in this area (*Hibi*, *Hansen* and *Miranda*) were summary reversals of Court of Appeals decisions upholding estoppel claims: "The extraordinary number of such dispositions in this single area of the law provides a good indication that our approach to these cases has provided inadequate guidance for the federal courts and served only to invite and prolong needless litigation." *Id.* at 422-23. This Court allowed that such cases "should be decided under a clearer form of analysis than 'we will know an estoppel when we see one.'" *Id.* at 423, *quoting Hansen, supra* p. 54, 450 U.S. at 792 (MARSHALL, J., dissenting). Nevertheless, *Richmond* continued to leave the door open to estoppel of the Government in some limited circumstances, although the Court's opinion strongly implied that the door should and will eventually be closed. *See* 496 U.S. at 423.

In the cause at bar, the theory of estoppel against the Federal Government has reared its head in a creative and insidious way: the Court of Appeals implicitly but unmistakably endorsed the concept of estoppel against the Federal Government when the Government itself, in a derivative claim for recovery over in indemnity, retrospectively acknowledges that it was estopped to enforce the law and therefore made a payment not otherwise authorized by federal law. If the VA were forthrightly to acknowledge its reliance in this case upon the theory that it was estopped to deny guaranty payments to the lenders under the applicable regulation, it would be have to argue the purported "affirmative misconduct" exception to this Court's general rule against estoppel in such circumstances. This Court, as part of its continuing effort to clarify the law in this important area, should close the door on estoppel claims against the Federal Government, at least to the extent of holding that the Government itself may not rely upon such estoppel derivatively in a case where the recipient of public money could not have relied upon the theory affirmatively; and perhaps to the further extent of closing the door altogether, as the Government itself has repeatedly urged this Court to do. *Richmond*, 496 U.S. at 423; *Community Health Services*, 467 U.S. at 60.

D. The Court of Appeals decision entails grave and widespread consequences for administration of numerous Federal Government programs affecting virtually the entire public.

The subject of estoppel of the Federal Government has been accorded a prominent role in this Court's recent jurisprudence, and with good reason. As this Court noted in *Community Health Services*, 457 U.S. at 60: "When the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined." Whenever there is a claim to money from the Public Treasury, the prospect of estoppel against the Federal Government invokes the undeniably paramount and comprehensive public policy consideration underlying the Appropriations Clause of the Constitution: "to assure that public funds will be spent according to the difficult judgments reached by Congress as to the common good and not according to the individual favor of Government agents or the individual pleas of litigants." *Richmond*, 496 U.S. at 428. In other words, estoppel against the Federal Government constitutes a threat to "regularity, punctuality, and fidelity, in the disbursements of the public money." 2 Story, *Commentaries on the Constitution of the United States* sec. 1348 (3d ed. 1858), quoted in *Richmond*, 496 U.S. at 427.

Any decision of a federal appellate court that endorses a theory of estoppel against the Federal Government, particularly in relation to a claim to money from the Public Treasury, carries the seeds of "pernicious effects" (*Richmond* at 433) that extend far beyond the interests of the parties to that particular case. Such authority encourages "endless litigation over both real and imagined claims of misinformation by disgruntled citizens, imposing an unpredictable drain on the public fisc." *Id.* Moreover, as the *Richmond* Court observed:

> The natural consequence of a rule that made the Government liable for the statements of its agents would be a decision to cut back and impose strict controls upon Government provision of information in order to limit liability. Not only would valuable informational programs be lost to the public, but the greatest impact of this loss would fall on those of limited means, who can least afford the alternative of private advice.

Id. at 433-34. The "interest in the citizenry as a whole in the ready availability of Government information" would thereby be unwisely sacrificed to the "inevitable fact of occasional individual hardship." *Id.* at 434.

There are countless situations in which private parties, in their diverse dealings with the Federal Government, may be tempted to claim that the conduct of particular Government agents should estop the Government from enforcing the letter of the law, and in particular that such conduct should force the Government to make payments that otherwise would be precluded under that law. As this Court observed in *Richmond*, "[i]t ignores reality to expect that the Government will be able to 'secure perfect performance from its hundreds of thousands of employees scattered throughout the continent.'" *Id.* at 433, *quoting Hansen v. Harris*, 619 F.2d 942, 954 (2d Cir. 1980)(Friendly, J., dissenting), *rev'd sub nom. Schweiker v. Hansen, supra* p. 54. Indeed, virtually the entire public interacts, in one way and at one time or another, with one or more Federal Government programs, and each such interaction carries with it the risk of a real or imagined informal understanding between a Government employee and a member of the public that contravenes the requirements of law.

The Court of Appeals opinion in this case is no less dangerous because its recognition of estoppel against the Federal Government is implicit, or because that recognition is at the instance of the Government itself in its derivative claim for indemnity; it is *more* dangerous for its insidious character. Moreover, many Federal Government loan programs, such as those of the Small Business Administration, Federal Housing Administration, Farmers Home Administration, and of course the VA, feature Government guaranties of private obligations, and concomitantly the Government's right to recovery over against the principal through subrogation or indemnity of those guaranty payments it is obligated to make under such programs. The operation of all such programs are substantially affected by the extent (if any) to which the Federal Government may be estopped to enforce program rules setting forth the conditions of guaranty payments; by the extent (if any) to which the Federal Government may rely (either explicitly or implicitly) on such an estoppel theory in a derivative action for recovery over in subrogation and indemnity against the principal; and most importantly, by uncertainty in judicial doctrine on these subjects.

Even if the effect of the Court of Appeals decision is considered only in the context of the VA home loan guaranty program--although the effect is much broader--that effect is nonetheless substantial. Although Congress has barred VA deficiency claims on loans closed after December 31, 1989 (*see* note 8, *supra*), the slow and painful process of collecting indemnity claims will be felt for many years to come by veterans whose disability benefits, retirement benefits and tax refunds are intercepted, and who will continue to be subjected to other collection efforts on account of purported indemnity liability to the VA. Many such claims against veterans--not only those in Wisconsin--would be eliminated if it were established that the corresponding guaranty payments by the VA to lenders were gratuitous. On the other side of the equation, this Court's declination to review the decision of the Court of Appeals would not result in substantial replenishment of the public fisc. The VA collects only a minuscule percentage of deficiency debt. Karen

Franklin, "When a House is Not a Home," *Veteran* (Nov./Dec. 1988) at 12 (according to Government Accounting Office Research, the VA collects only fourteen percent of debt from veterans, and incurs costs of about $11,000 to collect $3,000 of debt). Both as a matter of fiscal practicality and as a matter of fairness, the VA should recover its gratuitous guaranty payments from the windfall beneficiaries: the lenders. *See Veterans Administration General Counsel Opinion* 15-2a, *supra* p. 42 (VA has right to recovery payments not authorized by law despite course of dealing with payee). The Court of Appeals decision points the agency in precisely the opposite direction.[13]

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[13] If it is assumed *arguendo* that the VA instructed the lenders to waive obligors' personal liability for deficiencies, the veterans should nonetheless prevail on the basis of the reasoning of the four dissenting judges in *Carter v. Derwinski, supra* pp. 5-6. The dissenting opinion in that case correctly perceives the scope and character of the VA's indemnity right as explicated by this Court in *United States v. Shimer, supra* p. 15. In *Shimer*, this Court stated that the indemnity right flows from the "ordinary concomitants of a guaranty relationship" and that 38 C.F.R.

CONCLUSION

For the reasons stated, the petition for writ of certiorari should be granted.

Dated at Milwaukee, Wisconsin, this 3rd day of January, 1995.

Respectfully submitted,

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sec. 36.4323(e)(declaring the indemnity right) is "merely declaratory of a surety's customary right of indemnity." 367 U.S. at 386, 387-88. One of the basic principles of surety law thus incorporated is that "if the VA consents to the veteran's release from liability, the VA retains its liability on the guaranty and loses its rights of subrogation and indemnity from the veteran." *Carter* (dissent), *citing* Laurence P. Simpson, *Handbook on the Law of Suretyship* 227 (1950). The *Carter* dissent correctly observed that *Shimer* simply does not stand for the proposition that the VA may recover after authorizing the veteran's release from liability to the lender. This conclusion permits unfettered operation of a state law limiting the right to deficiency, such as that in Wisconsin, which need not be curtailed because it does not conflict with the VA's federal indemnity right. *See United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979); *Kamen v. Kemper Financial Services, Inc.*, 500 U.S. 90 (1991).

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UNITED STATES OF AMERICA, Plaintiff-Appellee, v. CHARLES DAVIS, Defendant/Third-Party Plaintiff-Appellant, v. JESSE BROWN, Secretary of Veterans Affairs, Third-Party Defendant-Appellee.

UNITED STATES v. DAVIS

No. 93-3104

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

34 F.3d 417

November 2, 1993[1] Submitted
August 24, 1994, Decided

PRIOR HISTORY: Appeal from the United States District Court for the Eastern District of Wisconsin. No. 90-C-0067. John W. Reynolds, Judge.

COUNSEL: For UNITED STATES OF AMERICA, Plaintiff - Appellee: Chris R. Larsen, AUSA, Thomas P. Schneider, USA, OFFICE OF THE UNITED STATES ATTORNEY, Milwaukee, WI. Jennifer H. Zacks, Mark

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[1] This being a successive appeal, it has been assigned to the same panel which heard the earlier appeal. See United States v. Davis, 961 F.2d 603 (7th Cir. 1992).

Stern, Malcolm L. Stewart, DEPARTMENT OF JUSTICE, Civil Division, Appellate Section, Washington, DC.

For CHARLES DAVIS, individually and on behalf of all others similarly situated, Defendant - Appellant: David Leen, LEEN & MOORE, Seattle, WA. Frederick R. Croen, CROEN & BARR, Milwaukee, WI. Charles H. Barr, CROEN & BARR, Milwaukee, WI.

For JESSE BROWN, Secretary of Veterans Affairs, Defendant - Appellee: Chris R. Larsen, AUSA, Thomas P. Schneider, USA, OFFICE OF THE UNITED STATES ATTORNEY, Milwaukee, WI. Jennifer H. Zacks, Mark Stern, Malcolm L. Stewart, DEPARTMENT OF JUSTICE, Civil Division, Appellate Section, Washington, DC.

JUDGES: Before CUDAHY, ESCHBACH and KANNE, Circuit Judges.

OPINIONBY: ESCHBACH

OPINION: ESCHBACH, Circuit Judge. Charles Davis, defendant and third-party plaintiff, on behalf of the class for which he is the representative, appeals the district court's denial of his motion for summary judgment and order of summary judgment for the plaintiff United States and thirdparty defendant Jesse Brown, Secretary of the Department of Veterans' Affairs ("VA"). For the reasons below, we affirm the district court. We have jurisdiction under 28 U.S.C. sec. 1291.

This case comes to us a second time after our remand to the district court for further proceedings. *See United States v. Davis*, 961 F.2d 603, 609 (7th Cir. 1992). Consequently, we did not hear further oral argument, but took this appeal on the briefs. In *Davis*, we held that the VA retained its independent federal indemnity right against veteran debtors, notwithstanding a lender's election to pursue a particular Wisconsin foreclosure procedure against the veteran debtors which eliminated the VA's right of subrogation. *See id.* at 610; *see also* 38 C.F.R. sec. 36.4323(e) ("Any amounts paid by the Secretary *on account of the liabilities of any veteran* guaranteed or insured under the provisions of 38 U.S.C. chapter 37 shall constitute a debt owing to the United States by such veteran."). Under the VA's home loan program, the VA guarantees home equity loans for veterans who pay the VA a fee. In Wisconsin, if a debtor defaults on his home loan, the lender may foreclose on the property by one of two statutorily prescribed methods. Under the first method, the debtor is afforded twelve months to redeem the property prior to the foreclosure sale. *See* WIS. STAT. sec. 846.04. Under the second method, however, the lender may expressly waive judgment as to any deficiency that might remain after the foreclosure sale in return for an expedited six-month redemption period. *See* WIS. STAT. sec. 846.101. In *Davis* we held that the VA is entitled to indemnity from the veteran debtor even though a lender proceeded under sec. 846.101 and foreclosed the VA's rights of subrogation. *See Davis*, 961 F.2d at 610.

The issue in this appeal is somewhat different. To preserve its right to reimbursement from the VA for any deficiency resulting from the sale of the property, a lender must give the VA 30 days' notice prior to foreclosing, and must follow the VA's subsequent instructions regarding the foreclosure proceeding. 38 C.F.R. sec. 36.4324(f). Section 36.4324(f) states, in relevant part:

> The release of personal liability of any obligor [veteran] on a guaranteed or insured obligation resultant from the act or omission of any holder [lender] without *the prior approval of the Secretary* shall release the obligation of the Secretary as guarantor or insurer, except when such act or omission consists of . . . an election and appropriate prosecution of legally available effective remedies with respect to the repossession or the liquidation of the security in any case, irrespective of the identity or the survival of the original or of any subsequent debtor, if holder [lender] shall have given such notice as required by sec. 36.4317 [requiring 30 days' notice to the VA] of this part and if, after receiving such notice, the Secretary shall have failed to notify the holder within 15 days to proceed in such manner as to effectively preserve the personal liability of the parties liable . . . .

(Emphasis supplied.) A lender who fails to comply with the VA's instructions or obtain approval from the VA Secretary prior to releasing the debtor from a deficiency obligation forfeits its right to reimbursement for any deficiency. *United States v. Church*, 736 F. Supp. 1494, 1497-98 (N.D. Ind. 1990). In *Davis*, we agreed with the holding in *Church* that where the VA pays lenders "despite the lack of any legal obligation to do so, the payment is 'gratuitous' and the VA is not entitled to indemnification." *Davis*, 961 F.2d at 611. In other words, if the VA reimburses a lender who failed to either follow the VA's instructions regarding the foreclosure proceeding or obtain the VA Secretary's approval, the VA's payment will be deemed "gratuitous" and the VA loses its right of indemnification from the veteran borrower. In Davis, we held that the VA could maintain its independent right of indemnification, but remanded to the district court to determine which of the lenders to the various class members failed to follow the VA's instructions. The VA may not seek indemnification from a veteran borrower for any VA payments to lenders who failed to follow the VA's instructions. *See id.*

On remand and cross-motions for summary judgment, the district court concluded that all lenders had followed the VA's instructions and that the VA was therefore entitled to indemnity from all of the class members. The district court found that after a lender notified the VA about a foreclosure action, the VA routinely sent a form letter stating in part: "in proceeding with such action, you should protect your rights against those liable, so as to protect our subrogated rights." The district court interpreted this sentence to mean that the lender could not proceed under sec. 846.101 because sec. 846.101's expedited remedy released the lender's, and by subrogation the VA's, right to sue the debtor for any deficiency. Instead, the district court interpreted the letter to require the lender to proceed under sec. 846.04. If this letter had been the only evidence, the district court concluded, the

VA's payments to lenders proceeding under sec. 846.101 would have been gratuitous. However, based on what the district court termed the VA's "additional course of dealing," the district court held that notwithstanding its initial letter, the VA's conduct permitted and indeed encouraged lenders to proceed under sec. 846.101.[2] Therefore, the VA's payments to the lenders were not gratuitous and the debtor veterans were still liable to the VA for any deficiency judgment. We review the district court's grant of summary judgment *de novo*. *Maher v. Int'l Bhd. of Elec. Workers*, 15 F.3d 711, 713 (7th Cir. 1994). Based on affidavits from staff members of Wisconsin's VA Office of District Counsel and attorneys who participated in the termination of VA-guaranteed loans in Wisconsin, the district court found that "the VA staff knowingly permitted Wisconsin lenders to foreclose pursuant to sec. 846.101, in order to reduce additional expenses which came with the longer redemption period . . . ." In other words, it was to the VA's advantage to proceed under sec. 846.101 because it expedited claims and reduced expenses. The district court concluded that this course of dealing amounted to "prior approval of the Secretary" under sec. 36.4324(f). As a result, the VA's payments to lenders were not gratuitous, and it thereby preserved its right to seek indemnification from the veteran debtors.

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[2] The VA even sent the lenders mortgage forms which stated that "in the event of foreclosure of this mortgage [the veteran] will be bound by the provisions of Section 846.101 of the Wisconsin statutes."

The veterans admit the existence of the VA's course of dealing, but they advance three different legal arguments why the VA gratuitously paid the lenders. We address them in turn.

The veterans first argue that this case is indistinguishable from *Church*, where the court held that the VA had no right of indemnification from the veteran debtor where it paid a lender who failed to follow the VA's instructions. In *Church*, after the lender notified the VA of its intent to foreclose, the VA sent the same form letter as it did here. Subsequently, the lender and the debtor entered into a forbearance agreement which averted the foreclosure. Ultimately, however, the lender did foreclose, even after the VA sent a second letter requesting the lender to preserve its subrogation rights.

Absent the VA's subsequent course of dealing, we agree that this case would be indistinguishable from *Church*. However, the court in *Church* did not consider the VA's course of dealing which encouraged lenders to use Wisconsin's six-month foreclosure proceeding. Instead, the court relied solely on the letters sent by the VA. Obviously, if the only instruction from the VA in this case were its letter, *Church* would be instructive. However, that is not the case here. The VA's course of dealing distinguishes this case from *Church* because it provides additional evidence of an "approval by the Secretary" as required by sec. 4324(f). Therefore, we find *Church* does not apply here.

The defendants also argue that the "informal understanding" between the lenders and subordinate VA employees in this case does not constitute "prior approval by the Secretary" and cannot overcome the clear meaning of the VA's form letter. They argue that the district court permitted the VA's "blanket approval" to release debtors from personal liability, rendering sec. 4324(f) meaningless. We agree in part that the VA's course of dealing amounts to a "blanket approval," but we fail to see how this vitiates the strictures of sec. 4324(f). Section 4324(f) requires the "prior approval of the Secretary" when a lender releases a debtor from personal liability except when such release constitutes an "election and appropriate prosecution of legally available effective remedies with respect to the repossession or the liquidation of the security in any case," the lender has given the VA timely notice, and the VA fails to instruct the lender within 15 days how to proceed. The operative component of sec. 4324(f) in this case is whether or not the lender had "prior approval of the Secretary," not whether the exception to sec. 4324(f)'s general rule applies. If a lender obtains prior approval of the Secretary, sec. 4324(f) has been satisfied and there is no need to rely on the exception contained therein.

The veterans also argue that the VA's own policies and procedures manual requires that the "prior approval of the Secretary" be in writing and signed by an appropriate VA official; here it was not. While evidence of a policy requiring written approvals would be relevant to determining whether the VA had a particular "course of dealing," sec. 4324(f) itself does not require written approval. Therefore, while perhaps violating its own internal policies, the VA's course of dealing may nevertheless satisfy sec. 4324(f)'s approval requirement even without written approval. The defendants do not contest the district court's factual findings and upon review we do not find them clearly erroneous.

Finally, the veterans argue that under contract law the VA was not bound by its course of dealing that contradicted its written instructions to the lender. Because the VA was not bound, they argue, it was not required to pay the lenders and therefore cannot seek indemnification from the veterans. To illustrate their contract argument, the veterans pose a hypothetical suit between a lender and the VA in which the VA claims it is not bound by its subsequent course of dealing because of its earlier explicit written instructions in its letter. The veterans contend the government would win this hypothetical suit, but we are not persuaded. Even if we assumed that contract law is the proper instrument with which to analyze the VA's obligations, we agree with the district court's factual finding that the VA's earlier letter notwithstanding, its course of dealing satisfied the lender's duty to obtain "prior approval of the Secretary." The fact that there was another instruction which did not give the lender permission to release the VA's rights of subrogation does not mean the VA's course of dealing could not constitute "approval of the Secretary." Moreover, the veterans' argument that the VA was bound by its earlier letter is plausible only if the letter was part of the agreement or contract between the VA and the lender. The letter was not an agreed upon term of the contract, but rather was part and parcel of the VA's performance. Therefore, it makes no difference that the VA's course of dealing contradicted an earlier instruction. Even under contract theory, then, the VA would still be bound to fulfill its guaranty obligations under its agreement with the lenders.

For these reasons we AFFIRM the district court.

UNITED STATES OF AMERICA, Plaintiff, v.
CHARLES DAVIS, Defendant. and CHARLES DAVIS,
individually and on behalf of all others similarly situated,
Third-Party Plaintiff, v. EDWARD DERWINSKI, or his
successor, Administrator of the Veterans Administration,
Third-Party Defendant

UNITED STATES v. DAVIS

Civil Action No. 90-C-0067

UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF WISCONSIN

756 F. Supp. 1162; 1991 U.S. Dist. LEXIS 1677

January 22, 1991, Decided
January 22, 1991, Filed

COUNSEL:

Christian R. Larsen, Assistant U.S. Attorney, Milwaukee, Wisconsin, for Plaintiff.

Charles H. Barr, Milwaukee, Wisconsin, and David A. Leen, Esq., Leen & Moore, Seattle, Washington, for Defendant.

JUDGES: John W. Reynolds, Senior United States District Judge.

OPINION BY: John W. Reynolds, Senior, United States District Judge.

OPINION: DECISION AND ORDER

BACKGROUND

On January 22, 1990, plaintiff United States of America ("United States") commenced an action against defendant Charles Davis ("Davis") alleging that he owed the United States $21,393.61 plus interest, administrative costs, and penalties. This debt was incurred as a result of the Veterans Administration ("the VA") guaranteeing the mortgage Davis executed in order to purchase his home. On March 6, 1990, Davis filed an answer to the United States' complaint and a third-party class action complaint against the VA alleging that the VA had waived its right to collect the money in question.

On May 16, 1990, this court conducted a status conference via telephone in which all parties agreed that there were no material questions of fact in dispute and that the case should be decided on cross-motions for summary judgment. On September 5, 1990, the briefing on the motions for summary judgment and class certification was complete, and on October 4, 1990, this court conducted a hearing to hear oral argument on the motions. This court certifies the class and subclasses proposed by Davis and grants Davis's and one of the subclasses' motion for summary judgment.

FACTS

Davis is a veteran of the United States Navy (Jul. 23, 1990 Davis Aff. para. 2). On August, 27, 1980, Davis and his wife purchased a home in Oak Creek, Wisconsin (*Id.* at para. 3). In order to purchase the home, Davis executed a mortgage note and mortgage to Suburban Coastal Corporation ("Suburban") in the amount of Sixty-one Thousand ($61,000.00) Dollars (*Id.* at Exhs. A-B). As part of the VA's loan guaranty program, the VA guaranteed payment of up to 40.98% of the $61,000.00 mortgage note or $25,000

(Jul. 23, 1990 United States Memorandum at 12). The VA application for the home loan guaranty program contains an indemnity agreement in which the veteran promises to repay the VA for any debt the VA incurs as a result of guaranteeing the loan:

> As a GI home loan borrower you will be legally obligated to make the mortgage payments called for by your mortgage loan contract. The fact that you dispose of your property after the loan has been made WILL NOT RELIEVE YOU OF LIABILITY FOR MAKING THESE PAYMENTS.
>
> * * * * * *
>
> . . . you will not be relieved from liability to repay any guaranty claim which the VA may be required to pay your lender on account of default in your loan payments. The amount of any such claim payment will be a debt owed by you to the Federal Government. This debt will be the object of established collection procedures.

(*Id*. at Exh. A).

In approximately March 1985, Davis became delinquent in payment of his mortgage, and the successor of Suburban, Anchorage Mortgage Services, Inc. ("Anchorage") issued a notice of default to the VA (*Id.* at Exh. D). On April 10, 1985, Anchorage filed a Notice to Foreclose with the VA (*Id*. at Exh. E), and on May 3, 1985, the VA responded by acknowledging Anchorage's intentions and instructed it to "protect your [Anchorage's] rights against those liable, so as to protect our [VA's] subrogated rights" (*Id.* at Exh. E1).

On September 9, 1985, Anchorage commenced a foreclosure action against Davis in the Milwaukee County Circuit Court (Jul. 23, 1990 Davis Aff. Exh. C). In Anchorage's complaint, it elected to proceed with the foreclosure pursuant to Wisconsin Statutes sec. 846.101 (*Id.* Exh. C at para. 3). This enabled Anchorage to (1) reduce Davis's redemption period from twelve to six months and (2) eliminate Davis's right to a finding by a circuit court that the sheriff sold the mortgaged property for "fair value." *Glover v. Marine Bank of Beaver Dam*, 117 Wis. 2d 684, 687, 345 N.W.2d 449 (1984). By proceeding under Wis. Stat. sec. 846.101, however, Anchorage waived the right to obtain a judgment against Davis for any deficiency. *Id.* at 688. The deficiency is the difference between the amount due on the defaulted home loan after foreclosure (including costs incurred in the foreclosure process) and the net amount realized from the sale of the security for the loan (usually the home itself).

Anchorage was able to proceed pursuant to Wis. Stat. sec. 846.101 because at the time Davis purchased his home, the VA specified the use of a mortgage instrument, "VA Form 26-6347," in which Davis agreed to permit Anchorage to proceed under this section during a foreclosure (Jul. 23, 1990 Davis Aff. Exh. B at para. 18). In addition, the VA does not dispute Davis's claim that the VA specified the use of this mortgage instrument for all of the veteran loans it guaranteed in Wisconsin.

On November 4, 1985, the Milwaukee County Circuit Court entered a judgment against Davis for the amount due on the mortgage note (Jul. 23, 1990 United States Memorandum Exh. F). This judgment provided that Davis's home could be sold at public auction conducted by the sheriff at any time after six months from November 4th (the redemption period) (*Id.* Exh. F at para. 5). In addition, the judgment stated that "no deficiency judgment may be obtained against the mortgagor defendants [the Davises]." (*Id.* Exh. F at para. 8).

On May 2, 1986, the VA issued bidding instructions to Anchorage, instructing Anchorage to bid $48,700.00 for the property if Anchorage desired to convey the property to the VA after the sale was complete (*Id.* at Exh. F2).[1] On May 5, 1986, the sheriff conducted a foreclosure sale at which Anchorage followed the VA's instructions and purchased the Davis's home for $48,700.00 (*Id.* at 12-13, Exh. G). On

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[1] This court notes that the record is unclear, and this court is uncertain as to how the VA determined that the Davis's home was worth $48,700.00. Although during oral argument this court asked the attorneys representing the parties to explain the calculation of this number and subsequently had this portion of the transcript transcribed to review their explanation, this court remains muddled as to how this value was determined.

May 19, 1990, the Milwaukee County Circuit Court entered an order confirming the sheriff's foreclosure sale (*Id.* at Exh. G). In support of the order confirming the sheriff's sale, Anchorage's attorney submitted an affidavit to the court which stated that "no deficiency is requested from the mortgagor/defendants, same being specifically waived by plaintiff." (Jul. 23, 1990 Davis Aff. Exh. F).

On June 3, 1986, Anchorage submitted to the VA a claim for payment of the difference between the debt the Davis's owed Anchorage ($71,131.61 at this point in time) and the price paid for the Davis's home at the foreclosure sale ($48,700.00) (Jul. 23, 1990 United States Memorandum Exh. H). The VA analyzed Anchorage's deficiency claim and concluded that Anchorage was entitled to $22,839.61 (*Id.* at Exhs. I-J). The VA paid Anchorage $22,839.61, and then sought reimbursement from Davis for this amount. Davis unsuccessfully requested the VA to waive its claim against him, and he has subsequently refused to pay the alleged debt. The VA intercepted Davis's 1987 and 1988 income tax refunds and commenced this action in order to obtain payment.

ANALYSIS

I. Summary Judgment

Fed. R. Civ. P. 56(c) provides that a federal district court shall grant a motion for summary judgment if the pleadings, depositions, answers to interrogatories, admissions, and affidavits indicate that no material facts are in dispute and that the moving party is entitled to judgment as a matter of law. *Howland v. Kilquist*, 833 F.2d 639, 642 (7th Cir. 1987). The party moving the court for summary judgment has the burden of proving that no material facts are in dispute, and the court must review the record with all reasonable inferences being drawn in favor of the non-moving party. *Egger v. Phillips*, 710 F.2d 292, 296 (7th Cir. 1983), *cert. denied*, 464 U.S. 918, 78 L. Ed. 2d 262, 104 S. Ct. 284 (1983); *Reardon v. Wroan*, 811 F.2d 1025, 1027 (7th Cir. 1987). In the present case, there are no material facts in dispute and a ruling on summary judgment is appropriate.

A. Veterans Administration's Rights Against the Veteran

Title 38 of the United States Code of Federal Regulations ("C.F.R.") Part 36.4323, entitled "Subrogation and Indemnity", provides the VA with two alternative theories for collecting on a deficiency owed by a veteran. First, sec. 36.4323(a) states that the VA is subrogated to the rights of the holder of the mortgage note (usually the lender) and that the VA can obtain repayment of a deficiency from the veteran under a subrogation theory. The regulations require the holder to give the VA thirty (30) days notice before pursuing a foreclosure action. 38 C.F.R. sec. 36.4317. This notice provides the VA with the opportunity to direct the holder as to how to proceed with the foreclosure action in state court. 38 C.F.R. sec. 36.4324(f); *See United States v.*

Church, 736 F. Supp. 1494, 1497-99 (N.D. Ind. 1990). In addition, if the holder releases the personal liability of the veteran without the permission of the VA, then the regulations release the VA from its obligation as the guarantor. *Id*.

Second, 38 C.F.R. sec. 36.4323(e) states that any amount paid by the VA as a result of a veteran's mortgage loan constitutes a debt owed by the veteran to the VA. This section applies directly to the indemnity agreement the veteran enters into with the VA as part of the application for the home loan guaranty.

In the present case, the VA concedes that it cannot recover from Davis based on the subrogation theory because in Anchorage's initial state court foreclosure complaint Anchorage waived its right to recover any deficiency by electing to proceed pursuant to Wis. Stat. sec. 846.101. As noted earlier, the VA's subrogation right to payment is based entirely on Anchorage's right to obtain a deficiency judgment, which Anchorage waived.

The VA, however, claims that it can recover under the indemnification theory because (1) Davis signed the application for the home loan guaranty which contained an indemnity agreement, and (2) the United States Supreme Court in *United States v. Shimer* held that the VA's right to indemnity is separate and distinct from the VA's subrogation right. 367 U.S. 374, 6 L. Ed. 2d 908, 81 S. Ct. 1554 (1961). Davis, on the other hand, argues that the facts of *Shimer* are distinguishable from the present case. Davis claims that the facts and holding of a case in the Ninth Circuit, *Whitehead v. Derwinski*, are directly on point, and that this court should follow the *Whitehead* decision. 904 F.2d 1362 (9th Cir. 1990).

B. *Shimer* as Compared to *Whitehead*

The Supreme Court in *Shimer* held that the federal regulations provided the VA with an independent right of indemnity against a veteran. The Court stated:

> Moreover, the recognition of a loss to the guarantor merely because of a failure of the lender's rights against the principal is incompatible with the background of general surety law against which the statute was drawn. Indeed, at the time of the 1945 amendments to the Act the Administrator had already ruled that there was a right to recover over against the veteran on a theory of indemnity in situations where recovery by way of subrogation was barred by state law.
>
> For these reasons, we are constrained to agree with the uniform construction of the lower courts, including that of the two courts below, that the statute affords an independent right of indemnity to the Veterans' Administration.

Shimer, 367 U.S. at 387 (citations omitted).

The Ninth Circuit Court of Appeals in *Whitehead*, however, narrowly interpreted the Court's holding in *Shimer*. The appellate court interpreted *Shimer* as holding that the VA only has an independent right to indemnity when the state law limiting the VA's right to subrogation directly conflicts with federal regulations. The appellate court stated:

> The federal statutory and regulatory scheme contemplates reliance on state foreclosure procedures. Where state procedures preclude holding the debtor personally liable, the VA retains its right to do so by way of indemnity. Where, as in the state of Washington, state foreclosure procedures afford the VA identical protections, there is no conflicting state law to displace.

Whitehead, 904 F.2d at 1369. Essentially, the appellate court held that the VA has a right to indemnity only when state law *always* bars the lender, and thereby the VA, from recovering a deficiency against the veteran. *Id.* If, however, state law permits the lender to preserve its and the VA's right to a deficiency by proceeding in a particular manner, then the VA forfeits its right to indemnity. *Id.*

Although this court agrees with the final holding in *Whitehead*, it is not convinced that the court of appeals' analysis distinguishing *Whitehead* from *Shimer* is persuasive or correct. First, the portion of the Supreme Court's decision in *Shimer* which discusses the conflict between state law and the federal regulations does not concern the issue of whether or not the VA has an independent indemnity right. The Court only discusses conflict between state law and federal regulations in the portion of its decision involving the issue of whether or not the VA, as a guarantor, is obligated to pay the lender for the veteran's deficiency. *Shimer*, 367 U.S. at 377-81.

In *Shimer*, the veteran had successfully argued in the appellate court that the VA could not recover from him any amount the VA was not obligated under state law to pay the lender on his behalf. *Id.* at 376-77. The Supreme Court, however, held that the appellate court should not have used state law to determine whether or not the VA was obligated to pay the lender, but should use the pertinent federal regulations. *Id.* at 380-81. In discussing the regulatory scheme applicable for determining the VA's liability to the lender, the Court stated:

> We have no doubt that this regulatory scheme, complete as it is in every detail, was intended to provide the whole and exclusive source of protection of the interests of the Veterans' Administration as guarantor and was, to this extent, meant to displace inconsistent state law.

Id. at 381 (footnote omitted). Thus, the Supreme Court's discussion in *Shimer* of conflict between state law and federal regulations does not pertain to the issue involving the VA's right to indemnity.

Second, in the portion of the Supreme Court's opinion which addresses the VA's right to indemnity, there is no discussion of this right being dependent on the state law always prohibiting the VA's right to subrogation. In fact, the Court explicitly rejected the veteran's argument that under the circumstances of the case, which were essentially identical to those in *Whitehead*, the VA could only recover on a theory of subrogation, not on a theory of indemnity.

Id. at 367. The circumstances in *Shimer* and *Whitehead* were identical because although state law permitted the lender to obtain a deficiency judgment against the veteran,[2] the lender waived its right. *Id.* at 377. In *Shimer*, however, the Court held that even though the lender's waiver also waived the VA's right to subrogation, the VA could collect against the veteran based on the independent indemnity agreement. *Id.* at 387-88. Thus, this court concludes that *Whitehead*, and the present case, are not distinguishable from *Shimer* on the grounds that the state law foreclosure statutes do not conflict with the federal regulations governing foreclosure procedures.

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[2] A deficiency judgment was available to the lender in *Shimer* as long as it obtained a court determination of the fair market value of the mortgaged property and credited that amount to the unsatisfied liability. *Id.* (citing Purdon's Pa. Stat., Tit. 12, sec.sec. 2621.1-2621.11); *see also Bank Leumi: LE-Israel, B.M. v. Zimmerman*, 396 Pa. Super. 409, 578 A.2d 967, 968-69 (1990).

This court, however, notes that the Ninth Circuit Court of Appeals in *Whitehead* also seemed to base its holding on the ground that the VA controlled whether or not the lender preserved the VA's subrogation right. *Whitehead*, 904 F.2d at 1369. The court of appeals stated:

> Because the VA directs the lender's choice between the two methods available [one maintains right to deficiency judgment] in Washington, it is in complete control of its ability to be made whole. Given the availability of the judicial foreclosure alternative, which allows the VA to exercise its primary right to subrogation and proceed directly against the debtor, the VA may not choose the non-judicial foreclosure alternative, and then resort to its right to indemnity.

Id. In addition, a United States District Court for the District of Minnesota has interpreted the *Whitehead* decision to be based primarily on the fact that the VA controlled whether or not it had a right to subrogation:

> The court's holding [in *Whitehead*] was based on the V.A.'s complete control of its power to be made whole when a state provides alternative methods of foreclosure.

> If a veteran defaults on a loan, the lender must
> give the V.A. thirty days notice before foreclosing. 38 C.F.R. sec. 36.4317. The V.A. then has fifteen days in which to notify the lender to proceed in "such manner as to effectively preserve the personal liability of the parties liable . . . ." 38 C.F.R. sec. 36.4324(f).

Vail v. Derwinski, 742 F. Supp. 1039, 1042 (D. Minn. 1990). After putting forth this observation, the district court then essentially adopted the *Whitehead* holding. *Id.* at 1043.

Neither the *Whitehead* nor *Vail* decisions, however, address the issue of how the VA's control over the lender distinguishes those cases from *Shimer*. In fact, this court finds that the facts regarding the VA's control over the lender were essentially identical in *Shimer*, *Whitehead*, and *Vail*. Regulation 38 C.F.R. sec. 36.4324(f), which was in effect at the time of *Shimer*,[3] explicitly states that if the lender releases the personal liability of the veteran, either via action or inaction, without the prior approval of the VA, then the VA's obligation as a guarantor expires. The practical effect of this regulation is that in *Shimer*, as in *Whitehead* and *Vail*, the VA had the power to direct the lender to follow those state law foreclosure procedures which preserved the lender's, and the VA's, right to obtain a deficiency judgment. If the lender refused to follow the VA's directions and released the veteran of his personal liability, then the VA would not be required to pay the lender as a guarantor of the mortgage note. *See Church*, 736 F. Supp. at 1497-99. Thus, this court concludes that the VA's control over the lender in *Whitehead* and in the present case, also does not distinguish this case from *Shimer*.

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[3] *See* 13 Fed. Reg. 7278, Nov. 27, 1948 as amended at 24 Fed. Reg. 6315, Aug. 6, 1959; 35 Fed. Reg. 7728, May 20, 1970; 46 Fed. Reg. 43673, Aug. 31, 1981; 52 Fed. Reg. 26342, Jul. 14, 1987.

C. *Shimer* is Not Controlling

This Court, however, is convinced that the Supreme Court would limit its holding in *Shimer* if it were to consider the facts that were present in either *Whitehead*, *Vail*, or the present case. In the present case, the parties agree that a lender seeking foreclosure in Wisconsin has a choice to either (1) waive its right to obtain a deficiency from the veteran in return for an expedited and less costly judicial foreclosure (Wis. Stat. sec. 846.101) or (2) maintain its right to deficiency by proceeding with a relatively more time consuming and costly judicial foreclosure (Wis. Stat. sec.sec. 846.10(2), 846.165(2)). There also is no dispute that the federal regulations provide the VA with the power, whether or not it chooses to exercise it, to direct the lender to foreclose in a manner which preserves the lender's and the VA's right to a deficiency. 38 C.F.R. sec. 36.4324(f). Finally, there is no dispute that if the lender fails to follow the VA's directions and forfeits its right to a deficiency, then the VA is not obligated to pay the lender for the deficiency amount. *Id.*; *Church*, 736 F. Supp. at 1497-99.

The problem with a broad interpretation of *Shimer* is that it permits the VA to obtain the benefits of Wisconsin's expedited foreclosure proceeding without having to incur the costs. There is no indication that the Supreme Court in *Shimer* ever considered or intended this outcome of its holding. More importantly, this result is inequitable and directly contravenes the intent of the Wisconsin foreclosure laws, and this court concludes that if the Supreme Court were to consider this result, then it would limit its *Shimer* decision. Thus, although this court finds that the pertinent facts of the present case are indistinguishable from those in *Shimer*, it holds that the VA is estopped from seeking a deficiency against a veteran under its indemnity agreement when the lender forecloses against the veteran pursuant to Wis. Stat. sec. 846.101.

II. Class Certification

The plaintiffs seeking certification of a class are required to satisfy the four requirements of Rule 23(a) of the Federal Rules of Civil Procedure, and at least one of the requirements of Rule 23(b).

A. Four Requirements of Rule 23(a)

Rule 23(a) requires the plaintiffs to demonstrate that:

> (1) The class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative party are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.

The plaintiffs have satisfied each of these four requirements, and therefore this court certifies the class and proposed subclasses.

1. Numerosity

The VA does not contest that the proposed class would be so numerous that joinder of all class members is impracticable (Aug. 21, 1990 Third-Party Defendant's Response

Memorandum at 3). Davis estimates that there are approximately two thousand (2,000) veterans from whom the VA is seeking to collect a deficiency which arose from a Wisconsin foreclosure (Jun. 29, 1990 Leen Aff. para. 5). Thus, this court concludes that joinder of all class members is impracticable, and the numerosity requirement of Fed. R. Civ. P. 23(a) is satisfied.

2. Commonality

There are questions of fact and law common to the proposed class. The legal issue in Davis's third-party complaint, which this court resolved on summary judgment, is identical for all members of the class: whether or not the VA can seek payment from a veteran for a deficiency based on the indemnity agreement when the VA's subrogation right to collect the deficiency against the veteran is not preserved in the Wisconsin state court foreclosure proceedings.

The relevant factual questions are also common to all members of the class. In light of this court's decision on the parties' cross-motions for summary judgment, the dispositive question of fact that remains is whether or not the VA's right to a deficiency judgment under a subrogation theory was preserved in the Wisconsin state court foreclosure proceeding which the mortgage note holder brought against the veteran. If this right were preserved, i.e. the holder did not proceed under Wis. Stat. sec. 846.101, then the VA can seek payment from the veteran for the deficiency it had to pay to the holder. If, however, the VA's right was not preserved, then the VA is enjoined from obtaining or seeking payment for the deficiency from the veteran. This court also notes that if the holder of the mortgage note ignored the VA's directions to preserve the VA's subrogation right, then the VA also is enjoined from seeking or obtaining payment from the veteran because the VA was not obligated, as a guarantor, to pay the holder for the deficiency. *Church*, 736 F. Supp. at 1497-99. Thus, this court concludes that the questions of law and fact are common to all members of the proposed class and the commonality requirement of Rule 23(a) is satisfied.

3. Typicality

This court finds that Davis's claim is typical of that which would be brought by all veterans whom the VA is currently seeking to obtain a deficiency judgment against based on the independent indemnity agreement. The VA, however, argues that Davis's claim is not typical of subclass #1 which Davis has proposed as follows:

> Those individuals, included in the above class, against hom a final judgment has been entered in a court of record on such claim.

(Jul. 23, 1990 Memorandum in Support of Class Certification at 2). Davis has requested this court to vacate all final judgments entered against this subclass and to order the VA to repay any monies obtained from this subclass. There are, however, legal issues regarding principles of res judicata which affect this subclass which neither Davis nor the VA has fully briefed. Thus, as a starting point, this court finds that Davis's motion for summary judgment on behalf of subclass #1 is denied without prejudice.

The typicality requirement, however, is primarily designed to ensure that the representative class plaintiffs are motivated to pursue the best interests of the class. In essence, this requirement "overlaps the requirements that the named representatives adequately represent the class, that there be common questions of law and fact, that such questions predominate, and that the class action be a superior means of resolution." *Eisenberg v. Gagnon*, 766 F.2d 770, 786 (3rd Cir. 1985), (citing H. Newberg, 1 *Newberg on Class Actions*, sec. 1115a (1977) and 3B *Moore's Federal Practices*, para. 23.06-2 (1985)), *cert. denied*, 474 U.S. 946, 88 L. Ed. 2d 290, 106 S. Ct. 342 (1985). Typicality, however, does not require the named plaintiff to be in the identical situation as every member of the class. *Adams v. Califano*, 474 F. Supp. 974 (D. Md. 1979), *aff'd* 609 F.2d 505 (4th Cir. 1979); *Penn v. San Juan Hospital*, 528 F.2d 1181, 1189 (10th Cir. 1975). The critical issue is whether or not the plaintiff's interests are antagonistic to the class.

In the present case, the interests of Davis are not antagonistic to the interests of proposed subclass #1. In addition, the record to date indicates that Davis and his attorney would adequately represent the interests of this subclass by vigorously pursuing an order vacating the deficiency judgments which the VA currently has against the members of that subclass. Thus, this court concludes that Davis's claim is typical of the claims of both the class and proposed subclasses and that the typicality requirement of Rule 23(a) is satisfied.

4. Adequacy of Representation

The final requirement of Rule 23(a) is that the representative parties will fairly and adequately protect the interests of the class. The VA argues that Davis will not fairly and adequately protect the interests of the entire class (specifically subclass #1) for the identical reasons that it argued that

Davis's claim was not typical of the class. As this court noted in the section regarding typicality, Davis's interests are not antagonistic to the interests of the members of subclass # 1, and the record indicates that he would fairly represent them.

The "adequacy of representation" requirement, however, also requires that counsel for the named representative be competent to handle the litigation. Davis's primary counsel, David A. Leen, successfully handled the *Whitehead* litigation, discussed at length herein, which renders him more than competent to handle this action. In addition, Davis's local counsel has experience with litigation in the federal court in the Eastern District of Wisconsin. *United States v. Citko*, 517 F. Supp. 233 (E.D. Wis. 1981). Thus, this court concludes that Davis will fairly and adequately protect the interests of the class and that the "adequacy of representation" requirement of Rule 23(a) is satisfied.

B. Requirements of Rule 23(b)

Fed. R. Civ. P. 23(b) provides in pertinent part:

> Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
>
> * * * * * *
>
> (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole.

The VA argues that this requirement is not satisfied because the VA did not participate in the mortgage holder's decision as to how to proceed with the state court foreclosure proceeding. In light of this court's summary judgment decision, this argument is unpersuasive.

First, the VA has acted similarly toward all members of the proposed class because the VA permitted the holder of the mortgage note to waive the VA's right to a deficiency judgment against the veteran based on a subrogation theory. As noted earlier, the question of whether or not the VA directed the holder to preserve the VA's subrogation rights is inapposite because (1) if the VA did not direct the holder how to proceed, then it was acquiescing in the holder's decision to waive the VA's subrogation right and (2) if the VA directed the holder to preserve the VA's subrogation right and the holder did not do so, then the VA was not obligated to pay the holder and there is no deficiency against the veteran. *See* 38 C.F.R. sec. 36.4342(f); *Church*, 736 F. Supp. at 1497-99.

Second, the proposed class is seeking to enjoin permanently the VA from seeking a deficiency from a veteran in Wisconsin based on the indemnity agreement the veteran entered into with the VA. The members of Davis's proposed subclass #2, however, also have requested equitable restitution for monies the VA has obtained from them prior to obtaining a deficiency judgment based on the indemnity agreement. In addition, the members of the proposed subclass #1, those veterans for whom the VA has obtained deficiency judgments, are seeking equitable restitution of the monies which the VA has collected from them. The amount due and owing to the members of both subclasses, however, is easily ascertainable from the records of the VA, and individual testimony of the subclass members does not appear to be required. Thus, this court concludes that the requirements of Rule 23(b)(2) are satisfied and certifies the following class and subclasses:

> CLASS: All veterans or widows of veterans or other individuals eligible for home loan guarantees or insurance provided pursuant to Title 38, United States Code, Chapter 37, against whom a claim has been or will be made by the United States pursuant to either 38 C.F.R. sec. 36.4323(e) or a written indemnity agreement, which claim arose or will arise because of a claim paid by the United States to a lender which submitted such claim to the United States as a result of a foreclosure conducted in the State of Wisconsin, in which the lender elected and was permitted to waive deficiency and accelerate the redemption period pursuant to Wis. Stats. sec. 846.101 (1989), but excluding any claims based upon foreclosure of mortgages executed after De- cember 31, 1989. This class includes the following subclasses:

> SUBCLASS #1: Those individuals included in the above class against whom a final judgment has been entered in a court of record on such claim; and
>
> SUBCLASS #2: Those individuals included in the above class from whom the VA has collected monies based upon a claim under 38 C.F.R. sec. 36.4323(e) or written indemnity agreement without having obtained a final judgment, by way of voluntary payment, offset of benefits or tax refunds, garnishment of wages or other collection efforts.

In addition, based on the summary judgment portion of this court's decision, this court grants summary judgment in favor of all members of subclass #2. This court, however, reserves ruling on summary judgment for subclass #1 and requests the parties to file briefs with this court as to whether or not this court should vacate the final judgments entered against members of subclass #1 and order the VA to repay the monies it has collected from the members of this subclass.

IT IS THEREFORE ORDERED that third-party plaintiff Charles Davis's motion for certification of the proposed class and subclasses defined herein is GRANTED.

IT IS FURTHER ORDERED that third-party plaintiff Charles Davis's motion for summary judgment on behalf of subclass #1 is DENIED without prejudice.

IT IS FURTHER ORDERED that on or before fourteen (14) days from the date of this order the parties shall submit briefs to this court on Charles Davis's motion for summary judgment vacating the judgments the Veterans Administration holds against the members of subclass #1. In addition, the parties shall have ten (10) days from the date they receive the other party's brief to file a responsive brief.

IT IS FURTHER ORDERED that third-party defendant Veterans Administration's motion for summary judgment against Charles Davis and the class and proposed subclasses is DENIED.

IT IS FURTHER ORDERED that third-party plaintiff Charles Davis's motion for summary judgment on behalf of himself and subclass #2 is GRANTED and the Veterans Administration is permanently enjoined as follows:

(1) from making assessments against members of subclass #2 for loan guaranty payments made to lenders following foreclosures of the real property security for VA guaranteed or insured loans, in which the provisions of Wis. Stats. sec. 846.101 were used;

(2) from terminating, setting-off against, reducing or otherwise denying VA benefits for which members of subclass #2 are eligible because of such assessments or claims;

(3) from denying eligibility to members of subclass #2 to VA home loan guarantee programs because of such assessments or claims;

(4) from undertaking or continuing any collection activity against the members of subclass #2 because of such assessments or claims.

IT IS FURTHER ORDERED that the Veterans Administration shall refund to the members of subclass #2 the monies it has collected from them, including the value of any benefits set-off against the claims. To facilitate this refund, the Veterans Administration shall provide to this court and serve upon third-party plaintiff on or before sixty (60) days from the date of this order an accounting of all the members of subclass #2 who may be entitled to refunds. The accounting shall:

(1) identify the individual members of subclass #2 by name, date of birth, social security number, service number (if different), branch of service, last known address, date of foreclosure, amount of deficiency assessed against claimant, amount collected, date file closed, reason file closed (e.g., payment, compromise, waiver, bankruptcy, death, etc. . .);

(2) indicate the amount of money due to subclass #2 as a result of this decision;

(3) provide third-party plaintiff's counsel copies of any backup documentation associated with the identification of the members of subclass #2;

(4) be certified by the Veterans Administration's general counsel as having identified all members of subclass #2 or provide an explanation as to why the accounting may be incomplete.

IT IS FURTHER ORDERED that third-party plaintiff shall file any objections to the accounting on or before twenty-one (21) days from the date he receives it and the Veterans Administration shall file, if it deems it necessary, a response to the objection within fourteen (14) days from receiving it.

IT IS FURTHER ORDERED that this court will address the following issues after the motion for summary judgment for subclass #1 is decided:

(1) the procedures for notifying members of subclass #2, and possibly subclass #1 of this decision and their right to obtain a refund from the Veterans Administration of the monies collected by the VA from them;

(2) the establishment of a fund to be used to pay claims filed by members of subclass #2 and possibly subclass #1;

(3) the procedures for filing a claim against and obtaining repayment from the fund;

(4) the creation of a final distribution plan for the fund including the possible distribution of unclaimed monies; and

(5) third-party plaintiff's application for attorney's fees and costs, including costs associated with administering the fund.

Dated at Milwaukee, Wisconsin, this 22nd day of January, 1991.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA,
Plaintiff,
v.

CHARLES DAVIS,
Defendant.

and

Civil Action No. 90-C-0067

CHARLES DAVIS,
individually and on behalf
of all others similarly situated,
Third-Party Plaintiff,
v.

EDWARD DERWINSKI,
or his successor, Administrator
of the Veterans Administration,
Third-Party Defendant.

DECISION AND ORDER

BACKGROUND

On January 22, 1991, this court entered a decision and order which: (1) certified a general class and two subclasses--subclass #1 and subclass #2; (2) granted summary judgment placing into effect an injunction against the United States Veterans Administration ("VA")[1] in favor of subclass #2; and (3) ordered the parties to brief the issue of whether or not summary judgment is appropriate on the claims of subclass #1. Subclass #1 is comprised of all veterans included in the general class against whom a final judgment has been entered in a court of record on a home mortgage default claim by the VA (Jan. 22, 1991 Dec. at 21).[2] The issue for determination on summary judgment is

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[1] Plaintiff United States of America and third-party defendant Edward Derwinski, Administrator of the Veterans Administration, are both represented by the United States Attorney's Office for the Eastern District of Wisconsin. These two parties have identical interests in this action and are referred to in this decision collectively as the VA.

[2] The general class and subclasses are defined as:

CLASS: All veterans or widows of veterans or other individuals eligible for home loan guarantees or insurance provided pursuant to Title 38, United States Code, Chapter 37, against whom a claim has been or will be made by the United States pursuant to either 38 C.F.R. sec. 36.4323 (e) or a written indemnity agreement, which claim arose or will arise because of a claim paid by the whether or not this court should vacate the judgments the VA already has obtained against the members of subclass #1 and order the VA to repay the monies it has collected from the members of this subclass. The parties completed the briefing of this issue on February 15, 1991.

On March 22, 1991, the VA: (1) moved this court pursuant to Rule 54(b) of the Federal Rules of Civil Proce-

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United States to a lender which submitted such claim to the United States as a result of a foreclosure conducted in the State of Wisconsin, in which the lender elected and was permitted to waive deficiency and accelerate the redemption period pursuant to Wis. Stats. sec. 846.101 (1989), but excluding any claims based upon foreclosure of mortgages executed after December 31, 1989.

SUBCLASS #1: Those individuals included in the above class against whom a final judgment has been entered in a court of record on such claim; and

SUBCLASS #2: Those individuals included in the above class from whom the VA has collected monies based upon a claim under 38 C.F.R. sec. 36.4323 (e) or written indemnity agreement without having obtained a final judgment, by way of voluntary payment, offset of benefits or tax refunds, garnishment of wages or other collection efforts.

Id.

dure for an order revising this court's January 22, 1991 decision; (2) moved this court pursuant to Fed. R. Civ. P. 62(c) for a partial stay of the January 22nd decision; and (3) filed with this court a notice of appeal of that portion of this court's January 22nd decision granting an injunction against the VA. On April 12, 1991, defendant and third-party plaintiff Charles Davis ("Davis"), on behalf of the class and subclasses, opposed the VA's motions. This court: (1) grants the VA's motion for summary judgment against the members of subclass #1; (2) denies the VA's motion for an order revising portions of this court's January 22, 1991 decision; (3) denies the VA's motion for a stay of portions of this court's January 22, 1991 decision; and (4) grants a 120-day extension to the VA to comply with certain portions of this court's January 22, 1991 decision.

ANALYSIS

I. Summary Judgment

Rule 56(c) of the Federal Rules of Civil Procedure provides that a federal district court shall grant a motion for summary judgment if the pleadings, depositions, answers to interrogatories, admissions, and affidavits indicate that no material facts are in dispute and that the moving party is entitled to judgment as a matter of law. Howland v. Kilquist, 833 F.2d 639, 642 (7th Cir. 1987). The party moving the court for summary judgment has the burden of proving that no material facts are in dispute, and the court must review the record with all reasonable inferences being drawn in favor of the non-moving party. Becker v. Tenenbaum-Hill Associates, Inc., 914 F.2d 107, 110 (7th Cir. 1990); Reardon v. Wroan, 811 F.2d 1025, 1027 (7th Cir. 1987). In the present action, the parties agree that there are no material facts in dispute regarding the legal claims of the members of subclass #1.

There is no dispute that the judgments on the collection actions against subclass #1 were obtained by the VA in federal court, and therefore federal rules of res judicata apply. Barnett v. Stein, 909 F.2d 973, 977 (7th Cir. 1990). The Seventh Circuit Court of Appeals has held that a party is barred by the doctrine of res judicata from filing a claim against a party if three elements exist: "(1) an identity of the parties or their privies; (2) an identity of the causes of action; and (3) a final judgment on the merits." Id. at 978 (quoting Conner v. Reinhard, 847 F.2d 384, 394 (7th Cir. 1988), cert. denied, 488 U.S. 856 (1988). In the present action, the definition of subclass #1 guarantees that the three elements for res judicata are satisfied for every member of the subclass.

However, the parties agree that the doctrine of res judicata is not an inflexible rule and that judgments can be overturned in an independent action when exceptional circumstances exist. In fact, the parties have cited the identical Tenth Circuit Court of Appeals decision, Winfield Associates, Inc. v. Stonecipher, for the legal rule of when vacating a judgment is appropriate. 429 F.2d 1087, 1090 (10th Cir. 1970).

In Winfield, the court of appeals stated:

> Rule 60(b), as amended, specifically preserves the right to attack a judgment by an independent equitable action. This right supersedes the various ancient writs recognized by the common law. Generally, such an independent action must show a recognized ground, such as fraud, accident, mistake or the like, for equitable relief and that there is no other available or adequate remedy. It must also appear that the situation in which the party seeking relief finds himself is not due to his own fault, neglect or carelessness. In this type of action, it is fundamental that equity will not grant relief if the complaining party "has, or by exercising proper diligence would have had, an adequate remedy at law, or by proceedings in the original action * * * to open, vacate, modify or otherwise obtain relief against, the judgment."

Id. at 1090 (footnotes omitted) (emphasis added) (quoting 49 C.J.S. Judgments sec. 343a). In addition, the Court of Appeals for the Fifth and Eighth Circuits and the District of

Columbia have stated that relief from an existing judgment should be limited to situations where it would be "manifestly unconscionable" to enforce the judgment. Johnson Waste Materials v. Marshall, 611 F.2d 593, 597 (5th Cir. 1980); Griffen v. Federal Deposit Ins. Corp., 831 F.2d 799, 802 (8th Cir. 1987); Carr v. District of Columbia, 543 F.2d 917, 927 (D.C. Cir. 1976). The parties, however, disagree as to whether or not the judgments the VA obtained against members of subclass #1 involve the type of exceptional circumstances which are necessary to nullify the doctrine of res judicata.

Davis, on behalf of subclass #1, argues that it would be manifestly unconscionable to enforce the existing judgments against the members of subclass #1 because: (1) the judgments were obtained as a result of the VA's misrepresentation of the law; (2) the class members' failure to challenge the VA's legal position was the result of excusable neglect; and (3) there is no meaningful distinction between members of subclass #1 and subclass #2. None of these arguments are persuasive.

First, the VA did not obtain judgments against the members of subclass #1 by misrepresenting the law. The VA relied on the United States Supreme Court holding in United States v. Shimer for the proposition that the VA had the right to recover under a theory of indemnity even though the lender had waived its right to subrogation. 367 U.S. 374 (1961). As this court recognized in its January 22, 1991 decision, the VA's interpretation of Shimer is not a misstatement of the law, but instead an extremely broad interpretation of that decision (Jan. 22, 1991 Dec. at 13-14). Accordingly, the VA's reliance on Shimer in obtaining the judgments against subclass #1 members does not constitute an exceptional circumstance requiring this court to overturn the judgments.

Second, the subclass #1 members' failure to challenge the VA's use of Shimer was not the result of excusable neglect. The fact that the VA may have more litigation resources than the individual members of subclass #1 does not mean that those individuals were denied their day in court. In addition, the unique relationship between the VA and the members of subclass #1, who are all veterans, did not require the VA to represent the individual member's interests in a foreclosure action. The individual members of subclass #1 had the opportunity to raise the exact defense against the VA which was raised by Davis, but they failed to do so. The Seventh Circuit Court of Appeals has stated that the doctrine of res judicata bars relitigation of matters which were raised or could have been raised in a previous action which resulted in a judgment. LaSalle Nat'l Bank of Chicago v. County of DuPage, 856 F.2d 925, 930 n.2 (7th Cir. 1988). Accordingly, the failure of the members of subclass #1 to defend successfully against the VA in previous litigation also does not constitute an exceptional circumstance.

Third, there is a critical distinction between members of subclass #1 and subclass #2 which warrants different treatment of the classes: the VA obtained judgments against the members of subclass #1 and not against the members of subclass #2. Although the VA may not have uniformly sought judgments against all members of the class, this fact does not require this court to set aside the judgments which the VA did obtain, and this court finds that it is not manifestly unconscionable to enforce those judgments. Thus, the doctrine of res judicata bars the claims of subclass #1, and summary judgment is granted on behalf of the VA.

II. Revision of January 22, 1991 Decision and Order

The VA has moved this court to rescind the portion of this court's January 22, 1991 decision which enjoins the VA:

> (2) from terminating, setting-off against, reducing or otherwise denying VA benefits for which members of subclass #2 are eligible because of such assessments or claims;

> (3) from denying eligibility to members of subclass #2 to VA home loan guarantee programs because of such assessments or claims;

(Jan. 22, 1991 Dec. at 23). The VA argues that this portion of the January 22nd decision should be rescinded because it is inconsistent with the statute governing the VA home loan guaranty program, Title 38 United States Code sec. 1802(b)(1)(B). Essentially, the VA is arguing that this court should reconsider its legal decision regarding the breadth of the injunction entered against the VA because this court has made a mistake of law.

The VA, however, also has appealed that portion of this court's January 22nd decision which granted an injunction against the VA. The Seventh Circuit Court of Appeals has held that "[t]he filing of a timely notice of appeal confers jurisdiction over the matter on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal." Henry v. Farmer City

State Bank, 808 F.2d 1228, 1240 (7th Cir. 1986) (citing Griggs v. Provident Consumer Discount Co., 459 U.S. 56, 58 (1982); Asher v. Harrington, 461 F.2d 890, 895 (7th Cir. 1972); Nicol v. Gulf Fleet Supply Vessels, Inc., 743 F.2d 298, 299 (5th Cir. 1984)).[3] Thus, this court does not have jurisdiction over the legal issues in this action involving the injunction against the VA, and the VA's motion to revise this court's January 22nd order is denied.

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[3] One exception to this general rule which at first glance appears applicable in this case is provided for in Rule 62(c) of the Fed. R. Civ. P. which states:

> When an appeal is taken from an interlocutory or final judgment granting, dissolving, or denying an injunction, the court in its discretion may suspend, modify, restore, or grant an injunction during the pendency of the appeal upon such terms as to bond or otherwise as it considers proper for the security of the rights of the adverse party.

Rule 62(c), however, has been interpreted as only providing a district court with jurisdiction to maintain the status quo; not with jurisdiction "to adjudicate anew the merits of the case after either party has invoked its right of appeal and jurisdiction has passed to an appellate court." McClatchy Newspapers v. Central Valley Typographical Union, 686 F.2d 731, 734 (9th Cir. 1982), cert. denied, 459 U.S. 1071 (1982). Thus, Rule 62(c) does not permit this court to consider the VA's motion.

III. Partial Stay of the January 22, 1991 Decision

The VA has moved this court for a stay of that portion of this court's January 22, 1991 decision requiring the VA to provide this court by March 22, 1991, a complete accounting of the refunds which members of subclass #2 may be entitled to. In support of its motion, the VA submitted the affidavit of the Finance Officer of VA Milwaukee Regional Office, Marjorie Petersen ("Petersen"). Petersen claims that she could not predict how long it would take to obtain and process the data required by this court's January 22nd decision (Feb. 22, 1991 Petersen Aff. ¶ 8). Petersen also stated that she had been in contact with her counterparts in the VA's regional office for Seattle, Washington, who were diligently working to comply with a similar request for data issued by a federal court in Whitehead v. Derwinski, 904 F.2d 1362 (9th Cir. 1990), and that they indicated that it would take her approximately one year to compile the data requested (Id. at ¶ 9). The VA, however, did not request a specific length of time which it wanted this court to stay its order, and did not explain why it would take one year to compile the data.

Davis, on behalf of the members of subclass #2, opposed the VA's motion. Davis argues that the VA has not produced sufficient evidence to support a claim that one year is required to compile the data required by this court's order. In addition, Davis argues that to the extent the VA is requesting a stay pending the appeal, the VA has not even attempted to prove the elements required to obtain a stay of the injunction: (1) the likelihood of success on appeal; (2) the harm to the VA if such relief is denied; (3) the harm to the members of subclass #2 if the stay is granted; and (4) whether or not the public interest is served by granting the relief. Armstrong v. O'Connell, 416 F. Supp. 1325, 1329-31 (7th Cir. 1976), aff'd, 539 F.2d 625 (7th Cir. 1976), vacated on other grounds, 433 U.S. 672 (1977). Finally, Davis argues that granting the VA's motion for a stay would substantially delay refunds to class members.

First, this court finds that it has jurisdiction to consider the VA's motion for a stay pursuant to Rule 62(c) because the motion does not involve the merits of the legal issues which have been appealed. See supra n.3. Second, this court finds that the VA has not requested a stay of this court's order pending the appeal, because the motion states that "[f]ollowing that time period [30 days from March 22, 1991], the plaintiff/third-party defendant [the VA] will exercise due diligence in an attempt to provide the remainder of the information required by the court's order." (Mar. 22, 1991 VA Motion at 2 (emphasis added)). The VA appears to be requesting a stay for as long a period as is required for it to compile the data required by this court's January 22, 1991 decision. This court will not grant such an indefinite and open-ended request, and therefore the VA's motion for a stay is denied.

However, this court finds that the affidavit submitted by the VA in support of its motion supports the VA's position that an extension of time to comply with this court's order is required. Thus, this court extends the 60-day time period for the VA to provide this court and Davis with a complete accounting of the refunds which members of subclass #2 may be entitled to by four months to October 1, 1991.

IT IS THEREFORE ORDERED that the third-party defendant Veterans Administration's motion for summary judgment against the members of subclass #1 is GRANTED and the claims of subclass #1 are dismissed.

IT IS FURTHER ORDERED that third-party defendant Veterans Administration's motion for an order revising this court's January 22, 1991 decision and order is DENIED.

IT IS FURTHER ORDERED that third-party defendant Veterans Administration's motion for an order indefinitely staying portions of this court's January 22, 1991 decision and order is DENIED.

IT IS FURTHER ORDERED that the time period the Veterans Administration has for filing with this court and serving upon third-party plaintiff an accounting of all members of subclass #2 who may be entitled to refunds is extended by four months to October 1, 1991.

Dated at Milwaukee, Wisconsin, this 31st day of May, 1991.

BY THE COURT:

/s/

John W. Reynolds
Senior Judge

UNITED STATES OF AMERICA, Plaintiff-Appellant,
v. CHARLES DAVIS, individually and on behalf of all
others similarly situated, Defendant/Third-Party Plaintiff,
Appellee, v. EDWARD DERWINSKI, or his successor,
Administrator of the Veterans Administration, Third-Party
Defendant-Appellant.

UNITED STATES v. DAVIS

No. 91-1678

UNITED STATES COURT OF APPEALS FOR THE
SEVENTH CIRCUIT

961 F.2d 603

January 9, 1992, Argued
April 3, 1992, Decided

SUBSEQUENT HISTORY:

Petition for Rehearing and Suggestion for Rehearing En Banc Denied May 18, 1992, Reported at 1992 U.S. App. LEXIS 10869. Supplemental Order of April 20, 1992, Reported at 1992 U.S. App. LEXIS 7273.

PRIOR HISTORY: Appeal from the United States District Court for the Eastern District of Wisconsin. No. 90-C 0067, John W. Reynolds, Senior Judge.

DISPOSITION: REVERSED and REMANDED

COUNSEL: For Plaintiff - Appellant: John E. Fryatt, USA, FTS 362-1700, Room 330, Chris R. Larsen, AUSA, FTS 362-1700, 414/297-1700, Room 330, OFFICE OF THE UNITED STATES ATTORNEY, 517 E. Wisconsin Avenue, United States Courthouse & Federal Building, Milwaukee, WI 53202, USA. Mark Stern, FTS 368-5089, 202/514-5089, Malcolm L. Stewart, 202/514-4821, Room 3631, DEPARTMENT OF JUSTICE, Civil Division, Appellate Section, 10th & Pennsylvania Avenue N.W., Washington, DC 20530, USA. Ann Southworth, USA, FTS 368-4214, 202/514-4214, 7410A, DEPARTMENT OF JUSTICE, Civil Division, 3342 Main Justice, 10th and Constitution Avenue, N.W., Washington, DC 20530, USA.

For Defendant - Appellee: David Leen, 206/325-6022, LEEN & MOORE, 520 E. Denny Way, Seattle, WA 98122, USA. Charles H. Barr, 414/276-6160, Suite 1275, 330 E.

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Washington Avenue, P.O. Box 7857, Madison, WI 53707-7857, USA.

JUDGES: Before CUDAHY and KANNE, Circuit Judges, and ESCHBACH, Senior Circuit Judge.

OPINION BY: ESCHBACH

OPINION: ESCHBACH, Senior Circuit Judge. Wisconsin's real estate foreclosure law allows lenders to choose between two different foreclosure routes. Route one gives the borrower a long redemption period but allows the lender to preserve its right to collect a deficiency judgment from the borrower. Route two provides for expedited foreclosure but requires the lender to forego its right to a deficiency judgment. This case involves an attempt by the Department of Veterans' Affairs (VA) to exercise its federal indemnity right to seek reimbursement from a veteran for a loan guaranty payment the VA made to a private lender on the veteran's behalf after the veteran's property was foreclosed by the lender. The question is whether the VA retains its federal indemnity right even though it allows a lender to choose route two, that is, expedited foreclosure and waiver of deficiency. For the reasons below, we hold that the VA may exercise its indemnity right to seek reimbursement for guaranties paid pursuant to its legal obligation. Accordingly, we reverse the injunction the district court entered to prohibit the VA from collecting such reimbursement and remand for further proceedings consistent with this opinion.

I. FACTS

Two statutory schemes, the VA's home loan program and Wisconsin's foreclosure law, are pertinent to this case. We discuss each in turn. Under the VA's nationwide loan guaranty program, the VA has provided housing assistance to qualified veterans since 1944 by guaranteeing home loans made to veterans by private lenders. *See* Title III of the Servicemen's Readjustment Act of 1944, Pub. L. No. 346, 58 Stat. 291 (codified as amended at 38 U.S.C. secs.

1801-33) [hereinafter Servicemen's Readjustment Act].[1] The VA has promulgated regulations governing all aspects of its loan guaranty program. *See* 38 C.F.R. part 36 (1988). Veterans are charged a one percent guaranty fee for a VA loan pursuant to 38 U.S.C. sec. 1829(a). In return, they are guaranteed a maximum interest rate that is usually below the market rate, see 38 U.S.C. sec. 1803(c); 38 C.F.R. sec. 36.4311, as well as limits on closing costs, loan origination, escrow and other fees, see 38 C.F.R. sec. 36.4312. Additionally, lenders usually forego the requirement of a down payment on a VA loan in return for the VA's guaranty. The VA's guaranty, by increasing the private lender's comfort level with the loan, induces them to make loans (or offer terms) which they otherwise might decline.

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[1] The issue we face in this case will not likely arise for veterans whose loans were closed after December 31, 1989. Veterans who pay an increased guaranty fee, and whose loans are closed after December 31, 1989, will not be liable to the VA for any loss resulting from a default on such loan, except in the case of fraud, misrepresentation or bad faith in obtaining the loan or in connection with the default. The Veterans' Benefits Amendments of 1989, H.R. 901, Pub. L. No. 101-237, sec. 304. These amendments raised the loan fee required by 38 U.S.C. sec. 1929 from one percent to 1.25 percent of the loan amount for veterans. Congress has since increased the fee to 1.875 percent for loans closed between November 1, 1990 and September 30, 1991. *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, sec. 8032. These and subsequent amendments have renumbered many of the statutory sections applicable in this case. Our citations are to the statutes applicable here rather than as renumbered.

If a veteran defaults on loan payments, the lender[2] may foreclose on the property. The VA regulations do not set forth a foreclosure procedure; foreclosure is effected according to the law of the state in which the property is located. *See* 38 U.S.C. sec. 1820(a)(6); 38 C.F.R. secs. 35.4319, 36.4320. The lender must give the VA thirty days' notice before beginning foreclosure proceedings. 38 C.F.R.

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[2] We use the term "lender," rather than mortgagee or holder, throughout this opinion for simplicity, although we recognize that the party foreclosing may not be the original lender because that lender may assign the mortgage before foreclosure. Similarly, we use the term "veteran" rather than "borrower" or "obligor" for simplicity, although we recognize that at the time of foreclosure the person being foreclosed upon may be the veteran's beneficiary or assignee.

sec. 36.4317. The VA then has fifteen days in which to give the lender instructions regarding the foreclosure proceeding. 38 C.F.R. sec. 36.4324(f). If the lender forecloses in accordance with the VA's instructions,[3] and a deficiency[4] remains after the sale of the property, the VA must reimburse the lender up to the amount of its guaranty. 38 C.F.R. sec. 36.4321.

Veterans participating in the VA program sign a contract with the VA that establishes the VA's right to seek reimbursement from the veteran for any payments the VA must make to private lenders pursuant to its guaranty of the veteran's loan. This guaranty agreement is governed by federal law.[5] The federal regulations adopted pursuant to this law provide two alternative courses by which the VA may recover from the veteran the amount paid on the guaranty. First, the VA becomes subrogated to the rights of the lender and can pursue any causes of action the lender might have had against the defaulting veteran. 38 U.S.C. sec. 1832; 38 C.F.R. sec. 36.4323(a). Under this subrogation right, the VA's rights are strictly derivative from the lender's rights. If, for instance, the lender could collect a deficiency judgment from the veteran, then the VA could step into the shoes of the lender and do so as well. Of course, if the lender's rights to a deficiency judgment against the veteran fail, then the VA's rights through subrogation fail as well. Second, the VA may pursue its indemnity right under its guaranty contract with the veteran to recover any amounts paid on the guaranty. 38 U.S.C. sec. 1832; 38 C.F.R. sec. 36.4323(e).[6] This indemnity right is a contractual one, arising directly from the contract between the veteran and the VA rather than deriving from the lender/veteran relationship.

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[3] A lender's noncompliance with the VA's instructions affects the VA's rights vis-a-vis the veteran. *See* United States v. Church, 736 F. Supp. 1494 (N.D. Ind. 1990). We put this issue aside for the moment. *See post* pp. 14-15.

[4] A deficiency refers to that amount which is the difference between the amount due on a defaulted home loan after foreclosure (including costs incurred in the foreclosure process) and the net amount realized from the sale of the security for the loan (usually the home itself). *See*, e.g., Wis. Stat. sec. 846.165

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[5] The VA's indemnity agreement with the veteran may appear in one of two forms. When the loan application is processed automatically by the lender, the indemnity agreement is set forth on VA Form 26-1820. When the veteran and the lender apply jointly for a guaranty (as did Davis), the agreement is set forth in VA Form 1802a, the "VA Application for Home Loan Guaranty." This form provides:

> The undersigned veteran and lender hereby apply to the Administrator of Veterans' Affairs for Guaranty of the loan described here under Section 1810, Chapter 37, Title 38, United States Code to the full extent permitted by the veteran's available entitlement and severally agree that the Regulations promulgated pursuant to Chapter 37, and in effect on the date of the loan shall govern the rights, duties, and liabilities of the parties.

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[6] 38 C.F.R. sec. 36.4323, entitled "Subrogation and indemnity," provides in relevant part:

> (a) The Secretary shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guaranty or on account of an insured loss, which right shall be junior to the holder's rights as against the debtor or the encumbered property until the holder shall have received the full amount payable under his contract with the debtor. No partial or complete release by a creditor shall impair the rights of the Secretary with respect to the debtor's obligation. . . .
>
> (e) Any amounts paid by the Secretary on account of the liabilities of any veteran guaranteed or insured under the provisions of 38 U.S.C. Chapter 37 shall constitute a debt owing to the United States by such veteran . . . .

Aside from these federal rights, Wisconsin's foreclosure law is also relevant to this case. Wisconsin law provides two statutory mechanisms by which a lender may foreclose on the mortgaged property of a debtor who is in default. The lender may demand in his complaint of foreclosure that judgment be rendered "for any deficiency which may remain due to him after sale of the mortgaged premises . . . ." Wis. Stat. sec. 846.04. If the lender proceeds under this section, the debtor is given twelve months to redeem the property.[7] Alternatively, the lender may choose expedited foreclosure if the borrower has previously so agreed. Under this route, the lender "may elect by express allegation in the complaint to waive judgment for any deficiency which may remain due to [him] after sale of the mortgaged premises," in which case a six-month redemption period applies. Wis. Stat. sec. 846.101.[8] It is this second route with which we are primarily concerned.

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[7] The redemption period is the period between the judgment of foreclosure and the foreclosure sale. During this time, the mortgagor may avoid the sale of the property by repaying the outstanding indebtedness.

Charles Davis is a veteran of the United States Navy who bought a home in Wisconsin through the VA's loan guaranty program. When Davis purchased his home, he executed loan documents and a mortgage with a private lender as well as a guaranty agreement with the VA. When Davis defaulted on his home loan, the lender foreclosed on his property pursuant to the second, expedited route as permitted by Davis' mortgage agreement. The lender subsequently sold

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[8] Section 846.101 reads in relevant part:

> The plaintiff in a foreclosure action of a mortgage . . . may elect by express allegation in the complaint to waive judgment for any deficiency which may remain due to the plaintiff after the sale of the mortgaged premises against every party who is personally liable or the debt secured by the mortgage.

Davis' property at a foreclosure sale for less than the outstanding balance on Davis' loan. Thus, a deficiency of approximately

$23,000 remained. Because the VA had contractually guaranteed Davis' loan for more than the remaining deficiency, the VA reimbursed the lender for the entire deficiency pursuant to its guaranty of Davis' loan. The VA then sought recovery of that amount from Davis under its federal indemnity right.[9]

In response to the VA's attempted recovery, Davis denied liability and filed a third-party class action complaint against Edward Derwinski, the Secretary of Veterans Affairs, challenging the VA's right to recover payments it has made pursuant to its loan guaranties. Davis asserts that just as the VA lost its subrogation right when the lender foreclosed under section 846.101, it also lost its indemnification right. He argues that the VA was required to direct the lender to foreclose under section 846.04, rather than section 846.101, if it wanted to preserve its indemnification right. After both Davis and the VA filed cross-motions for summary judgment, the district court agreed with Davis, essentially finding that the VA was "estopped" from asserting its indemnity right when it allowed a lender to foreclose under section 846.101. The district court entered an order which certified the class and subclasses proposed by Davis, denied the VA's motion for summary judgment, granted summary judgment for one of Davis' subclasses, permanently enjoined the VA from collecting indemnity payments from any veterans whose property was foreclosed pursuant to section 846.101, and ordered the VA to refund indemnity payments previously collected. Based on that injunction, the United States and Derwinski appealed. *See* 28 U.S.C. sec. 1292(a).

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[9] Because the lender had foreclosed Davis' property under section 846.101, it had waived its right to a deficiency. Thus, the VA's subrogation right, which allows it to step into the lender's shoes, would not have provided the VA an effective collection route.

II. DISCUSSION

We do not write on a clean slate in this case. First, the VA has long interpreted its enabling legislation, see Servicemen's Readjustment Act sec. 504, as providing it a federal indemnity right that is unaffected by state foreclosure law. *See* Decisions of the Administrator of Veterans' Affairs, No. 625 at 1154 (Jan. 22, 1945); 38 C.F.R. sec. 36.4323(e); *see also* VA Form 26-1820; VA Form 26-1820a. The VA's interpretation of the statute is controlling unless "plainly erroneous or inconsistent with the regulation." *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). Second, the Supreme Court has previously considered, and upheld, the VA's right of indemnity against veterans for amounts it must pay lenders pursuant to its guaranty obligation. In *United States v. Shimer*, 367 U.S. 374 (1961), the Supreme Court considered the VA's home loan program and upheld the validity of the VA's independent right of indemnification under section 36.4323(e). In *Shimer*, as in this case, the VA sought to collect monies from a veteran pursuant to its indemnity right rather than its subrogation right (recognizing in both cases that its subrogation rights were ineffectual because the lender had not preserved its rights to a deficiency judgment against the veteran). The lender in *Shimer*, after purchasing the property at a judicial sale, failed to file a petition to fix the fair market value of the foreclosed property pursuant to the Pennsylvania Deficiency Judgment Act. According to the Pennsylvania statute, this failure permanently discharged both the debtor and the guarantor from liability on the debt. The Third Circuit looked to this state law and determined that the VA was thus not obligated to pay the lender on its guaranty. Applying basic principles of surety law, the court held that the VA could not recover from its principal, *Shimer*, any amount it was not obligated to pay the lender on his behalf. *See United States v. Shimer*, 276 F.2d 792 (3d Cir. 1960).

The Supreme Court reversed the Third Circuit's decision, holding that the application of state law to determine the

VA's obligation to the lender was inconsistent with the applicable regulations prescribed by the VA to compute guaranty claims. *Shimer*, 367 U.S. at 377-81 (discussing 38 C.F.R. sec. 36.4321). The Court stated that it had "no doubt that this regulatory scheme, complete as it is in every detail, was intended to provide the whole and exclusive source of protection of the interests of the [VA] as guarantor and was, to this extent, meant to displace inconsistent state law." *Id.* at 381. More significantly, the Court went on to consider Shimer's argument that even though the VA was obligated on its guaranty to the lender, the VA nevertheless had no right to indemnity from him. *See id.* at 386. The Court disagreed with *Shimer* and held that the VA enjoys an "independent right of indemnity." *Id.* at 387. "We cannot agree that Congress . . . intended to relieve the veteran of direct liability for amounts properly paid on his behalf" by the VA. *Id.* at 386. Thus, *Shimer* upheld both the lender's federal right to receive payment from the VA on its guaranty of a veteran's loan and the VA's federal right to indemnity from the veteran for paying the lender on that guaranty.

We think that *Shimer* controls this case and compels us to reverse the district court's order; the VA may exercise its federal indemnity right to seek reimbursement from veterans for guaranty obligations which it was legally obligated to pay, and did pay, lenders. Although the district court found "the pertinent facts of the present case indistinguishable from those in *Shimer*," it held that the "VA is estopped from seeking a deficiency against a veteran under its indemnity agreement when the lender forecloses against the veteran pursuant to Wis. Stat. sec. 846.101." R. 36 at 14. The district court declined to apply *Shimer* because in *Shimer* the VA was not completely able to control its power to be made whole through subrogation as it arguably is in Wisconsin. Under the Pennsylvania foreclosure scheme, a lender makes an election to pursue a deficiency judgment *after* the foreclosure sale and *after* the VA's guaranty obligation has been established and paid. Thus, the VA had no string with which to control the lender at the time of the lender's election to pursue a deficiency. In Wisconsin, by contrast, the lender makes the election in the foreclosure complaint itself. Thus, in Wisconsin, the VA could require a foreclosing lender to use section 846.04, rather than section 846.101, and thereby preserve its subrogation right. The district court believed that because the VA enjoyed the option of preserving its subrogation right it would be inequitable to permit the VA to forego that right by allowing a lender to foreclose under section 846.101, but then nonetheless rely on its indemnity right to collect amounts paid on its guaranty from the veteran. Thus, the district court estopped the VA from asserting its indemnity right when the VA allows a lender to foreclose under section 846.101. In so doing, we believe that the district court erred in penalizing the VA for relying on a federal right that the Supreme Court has upheld as a legitimate exercise of the VA's authority to administer the veterans' home loan program. *See Shimer*, 367 U.S. at 381-85.

Simply because the VA could have instructed lenders to proceed under section 846.04, and arguably preserved its subrogation rights, does not provide us authority for insisting that it take that course of action. There is no textual basis in the statute and regulations governing the VA's home loan program that compels us to force the VA to privilege its subrogation right over its indemnification right. Moreover, in *Shimer*, the Supreme Court gave no indication that the VA's federal indemnity right was subject to qualification depending upon whether the VA's subrogation right was available. *See Shimer*, 367 U.S. at 386-88. Davis argues, however, that we should follow a recent decision of the Ninth Circuit and hold, as did that court, that the VA has a right to indemnity only when state law always bars the lender, and thereby the VA through subrogation, from recovering a deficiency against the veteran. *Whitehead v.*

Derwinski, 904 F.2d 1362, 1369 (9th Cir. 1990). The Ninth Circuit required the VA to rely upon its subrogation right rather than its indemnity right when it could ensure that its subrogation right was protected. *Id.* Although we concede that the facts of this case and those in *Whitehead* are materially indistinguishable, we respectfully disagree with the analysis employed by the Ninth Circuit in that case. First, the Ninth Circuit characterizes the VA's subrogation right as "primary" without providing any authority for that proposition. *See id.* ("Given the availability of the judicial foreclosure alternative, which allows the VA to exercise its primary right to subrogation and proceed directly against the debtor, the VA may not . . . resort to its right to indemnity."). As we have noted above, we discern no fair support for characterizing the VA's subrogation right as "primary" and thus respectfully decline to follow our Ninth Circuit colleagues. The only other circuit to consider the issue before us has likewise declined to follow *Whitehead*. *See Vail v.*

Derwinski, 946 F.2d 589, 591-92 (8th Cir. 1991) ("No rationale exists" for *Whitehead*'s conclusion that the VA's indemnity right was essentially a backup for subrogation). Likewise, we think it unwise to follow the path laid down in dicta by the Ninth Circuit in *Whitehead* and speculate on whether the Supreme Court would significantly limit *Shimer* because of an evolved conception of federal-state relations.[10]

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[10] Moreover, it not necessary for us to perform a "preemption" analysis in this case as did *Whitehead* in dicta. *See Whitehead*, 904 F.2d at 1369-72. A further reason for our holding that Wisconsin's statutory restrictions on deficiency judgments do not preclude the VA's suit for indemnification against Davis is that it is by no means clear that the Wisconsin statute at issue even applies to relationships between a debtor and third parties such as guarantors. Section 846.101 by its terms speaks of the "plaintiff's" election of remedies and consequent waiver of rights. *See* Wis. Stat. sec. 846.101. The "plaintiff" in Davis' foreclosure action was the lender, not the VA. This will usually be the case, as the VA does not itself prosecute foreclosure actions unless the lender fails to exercise reasonable diligence in foreclosing. *See* 38 C.F.R. sec. 36.4319(f). Neither party was able to locate any Wisconsin case law addressing question. Our own search of Wisconsin's case law has likewise yielded no clear guidance. In the only recent case to address section 846.101, the Wisconsin Supreme Court noted without deciding that the

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party waiving its right to a personal deficiency under section 846.101 is the *mortgagee*. *See Glover v. Marine Bank of Beaver Dam*, 117 Wis. 2d 684, 345 N.W.2d 449, 456 (1984) ("This [section 846.101's] protection comes in the form of a waiver of personal deficiency by the mortgagee."). Thus, for us to reach the question of whether the VA's regulation preempts section 846.101, we must first assume the two laws conflict. It is unnecessary for us to make this assumption and therefore unnecessary as well for us to embark on a preemption analysis. Accord *Vail*, 946 F.2d at 592 (VA's indemnity right upheld despite VA's acquiescence in lender's use of expedited foreclosure proceeding because Minnesota law affirmatively recognizes that rights of third parties under contracts of guaranty survive anti-deficiency laws; no preemption analysis necessary to decide case).

The State of Wisconsin filed a brief in this case as amicus curiae. We note that Wisconsin does not argue that section 846.101 generally releases guarantors as well as debtors. Rather, Wisconsin expresses two concerns in asking us to affirm the district court. The first is its "interest in the uniform application of its laws to all lenders." Brief for the State of Wisconsin as Amicus Curiae 2. Because the VA is not a lender, but a guarantor, our decision does not disturb any parity among lenders that Wisconsin seeks to maintain. Wisconsin's second concern is that veterans "may lose part of their other means of support as the VA tries to collect deficiency judgments from veterans' pensions and other federal entitlements." *Id.* While we, too, empathize with the plight of one subject to foreclosure and debt collection, we are constrained to respect the resolution of conflicting policy objectives reached by Congress in establishing the veterans' home loan program as well as the expertise of the VA in

See Whitehead, 904 F.2d at 1369-71. The Supreme Court has consistently discouraged courts of appeal against such an approach: "If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484, 109 S. Ct. 1917, 1921-22 (1989). We believe that *Shimer* is directly applicable to this case and therefore choose to follow its lead in sustaining the VA's independent federal indemnity right.

Davis next presses the theory that regardless of whether we find *Whitehead*'s reasoning persuasive, equity provides us with a basis on which to uphold the district court's

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carrying out those congressional directives. We decline to turn a loan guaranty program into a "grant of aid." *See Shimer*, 367 U.S. at 386 ("Relief from liability in these circumstances would convert a guaranty into a grant of aid.").

injunction against the VA. Put differently, Davis accuses the VA of reaping the benefits of Wisconsin's expedited foreclosure law while disavowing its burdens--an option not available to lenders in Wisconsin. While we agree with Davis that the VA may enjoy rights in addition to those that lenders enjoy, we think that Davis' comparison between the VA and *lenders* misses the mark. The VA is not a lender; it is a guarantor. Moreover, it is a guarantor under a comprehensive federal program specifically designed to regulate the VA/lender and VA/veteran relationships. The VA home loan program establishes a separate federal scheme for determining the "benefits and burdens" of both the VA/lender and VA/veteran relationships. State law is left to regulate the lenders' and veterans' rights as against each other. *See Farm Credit Bank of Saint Paul v. Lord*, 470 N.W.2d 265, 270 (Wis. 1991) (right or equity of redemption afforded mortgagor vis-a-vis mortgagee is created solely by state law), *cert. denied*, 112 S. Ct. 440 (1991). It is this separate scheme of benefits and burdens that we must uphold, provided it represents a valid exercise of the agency's authority (and Davis does not challenge any of the VA regulations as implemented). *See Shimer*, 367 U.S. at 382. Thus, even if the "benefits and burdens" of the VA home loan program are different in kind or degree from those provided non-VA participants, this does not produce inequity between the VA and non-VA participants. There is nothing inequitable in treating differently groups that are not similarly situated. Cf. Catharine MacKinnon, *Difference and Dominance in Feminism Unmodified: Discourses on Life and Law*, 32-45 (1987) (law often mistakenly equates treating people the same with treating them equally).

Furthermore, Davis premises his equitable argument on the unjustified assumption that veterans are similarly situated to other borrowers in Wisconsin. Again, this is not the case. Davis, like other participants in the VA's home loan program, availed himself of a favorable federal program that is not open to all borrowers. Now, he asks us to treat him "just like everyone else" when he benefitted from not being treated like everyone else in the first place. In addition to the favorable lending terms for veterans explained above, the VA program also provides veterans with various protection in the event of default and foreclosure.[11] Davis signed a guaranty contract with the VA establishing the VA's indemnity right and agreeing that federal law would govern the contract. Although the VA's protection of veterans in the event of foreclosure may be different from that protection Wisconsin has elected to provide its borrowers, it is certainly not for us to say that an extended redemption period would be more fair to veterans than the procedures the VA has promulgated. Furthermore, Davis has not challenged any of the VA's regulations themselves, which of course he would have been free to do. We disagree with Davis that we should prevent the VA from exercising its indemnity right on equitable grounds. Consequently, we find no basis on which to limit *Shimer*'s conclusion that the VA's subrogation and indemnification rights are independent, legitimately promulgated, federal rights, *Shimer*, at 386-87, and thus no basis on which to require the VA to privilege ts subrogation right over its indemnification right.

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[11] The first is an extensively regulated determination of the fair value of the mortgaged property. *See* 38 C.F.R. sec. 4320. Before the VA may collect a debt resulting from its payment of a guaranty, a veteran may challenge the existence or amount of the debt. 38 C.F.R. sec. 1.911a(c). Additionally, a veteran may request a waiver on the ground that he is not materially at fault and that collection would violate equity and good conscience. 38 U.S.C. sec. 3102(b) and (c); 38 C.F.R. sec. 1.911a(c). The veteran is entitled to a hearing on the waiver request and may appeal an adverse decision to the Board of Veterans Appeals. *Id.* The veteran may then seek further review before the newly created Court of Veterans Appeals and the Court of Appeals for the Federal Circuit. *See* Pub. L. No. 100-687, secs. 301,402. If a waiver is denied, the veteran may seek to compromise the debt with the VA. 38 C.F.R. sec. 1970.

Finally, we come to an issue that we set aside at the start of our discussion (*see ante* at n.3). The district court suggested that the VA may have instructed some lenders in Wisconsin to effect foreclosure by a method that would preserve the personal liability of the debtor, and that some lenders may have ignored the VA's instructions. Under 38 C.F.R. sec. 36.4324(f), noncompliance with the VA's instructions as to the appropriate method of foreclosure would relieve the VA of liability as guarantor. If the VA pays lenders in this situation despite the lack of any legal obligation to do so, the payment is "gratuitous" and the VA is not entitled to indemnification. *United States v. Church*, 736 F. Supp. 1494, 1497-98 (N.D. Ind. 1990). In the present case, the VA interpreted the district court's opinion as agreeing with Church. Moreover, the VA states in its brief to this Court that "[we do] not challenge that aspect of the district court's ruling; we argue only that the VA is entitled to indemnification for all guaranty payments that it was legally obligated to make. If this Court accepts our position, a remand is necessary so that the district court can determine which of the lenders did and did not comply with the applicable regulations." Brief of Appellant at 14. The

VA's point is well taken; we remand to the district court for farther proceedings consistent with this opinion.

REVERSED and REMANDED

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

April 20, 1992.

Before

Hon. RICHARD D. CUDAHY, Circuit Judge

Hon. MICHAEL S. KANNE, Circuit Judge

Hon. JESSE E. ESCHBACH, Senior Circuit Judge

No. 91-1678

UNITED STATES	)Appeal from the United
OF AMERICA,	) States District Court
Plaintiff-Appellant	) for the Eastern District
	) of Wisconsin.
v.	)
	) 90 C 0067
CHARLES DAVIS, individually	) John W. Reynolds,
and on behalf of all others	) Senior Judge
similarly situated,	)
Defendant/Third-Party	)
Plaintiff-Appellee,	)
	)
v.	)
	)
EDWARD DERWINSKI, or his	)
successor, Administrator of	)
the Veterans Administration,	)
Third-Party	)
Defendant-Appellant,	)

ORDER

On April 3, 1992, our decision in *United States v. Davis*, No. 91-1678, slip op. (7th Cir. Apr. 3, 1992) was published, which reversed an injunction entered against the Veteran's Administration (VA) prohibiting the VA from exercising its federal indemnity right to seek reimbursement for guaranties paid on behalf of veterans participating in its VA home loan program. Additionally, we remanded the case for further proceedings, including a determination of whether part of the appellee class may be relieved of liability to the VA on the authority of *United States v. Church*, 736 F. Supp. 1494, 1497-98 (N.D. Ind. 1990) (holding that under 38 C.F.R. sec. 36.4324(f), a lender's noncompliance with the VA's instructions releases the VA from its guaranty obligation to the lender, and in turn, also releases the veteran from his obligation to the VA).

Unbeknownst to this panel until April 6, 1992, the appellee class filed a motion to dismiss this appeal as moot on March 30, 1992. The appellee class argues that it is *entirely* composed of individuals who would be released of liability to the VA under *Church*., thus mooting the appeal on the merits. The motion is based on (1) the VA's admission in its appellate brief (and confirmed during oral argument) that it does not challenge *Church* or its application where appropriate in this case and on (2) "subsequent discovery which has disclosed that all members of the class are entitled to relief pursuant to the VA's admission." Motion of Appellee Class to Dismiss Appeal on Ground of Mootness. The "subsequent discovery" relied upon is a request for admissions recently served on the VA by the appellees, to which appellees' counsel indicates the VA has not responded by the applicable deadline. Appellees' counsel states by way of affidavit that Christian Larsen, the Assistant United States Attorney representing the VA, desires to defer its response to the discovery requests until disposition of the appeal. The appellee class asks us to view the requested admissions, the VA's alleged failure to respond, and its counsel's conversation with Mr. Larsen as an admission by the VA that it has no indemnity rights with respect to any member of the appellee class.

The issue of what portion of the appellee class is covered by *Church* and the VA's concession regarding its application, however, presents a factual question best resolved by the district court. So, too, issues presented by ongoing discovery in this case are best left to the district court to address. In short, appellees' motion asks that we resolve factual issues that are appropriate for the district court to resolve on remand. Accordingly, we direct the district court to consider the issue of the applicability of *Church* to the plaintiff class on remand as instructed in our opinion. *See United States v. Davis*, No. 91-1678, slip op. at 14-15.

UNITED STATES OF AMERICA, Plaintiff, v. CHARLES DAVIS, Defendant. and CHARLES DAVIS, individually and on behalf of all others similarly situated, Third-Party Plaintiff, v. JESSE BROWN, Secretary of Veterans Affairs, Third-Party Defendant. and UNITED STATES OF AMERICA, Plaintiff, v. LEONARD H. REDINGER, Defendant.

UNITED STATES v. DAVIS

Civil Action No. 90-C-0067 consolidated with Civil Action No. 90-C-1112

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WISCONSIN

March 17, 1993, Decided
March 17, 1993, Filed

COUNSEL: For Plaintiff: Christian R. Larsen, Assistant U.S. Attorney, 517 E. Wisconsin Ave., Milwaukee, WI 53202.

For Defendant: Charles H. Barr, Two Plaza East, Suite 1275, 330 E. Kilbourn Ave., Milwaukee, WI 53202, David A. Leen, Leen & Moore, 520 E. Denny, Seattle, WA 98122.

JUDGES: Reynolds

OPINION BY: BY THE COURT; JOHN W. REYNOLDS

OPINION: DECISION AND ORDER

This class action involves veterans whose loans were guaranteed by the Veterans Administration ("VA") pursuant to a home loan guaranty program. On January 22, 1991, this court certified the following class:

> All veterans or widows of veterans or other individuals eligible for home loan guarantees or insurance provided pursuant to Title 38, United States Code, Chapter 37, against whom a claim has been or will be made by the United States pursuant to either 38 C.F.R. sec. 36.4323(e) or a written indemnity agreement, which claim arose or will arise because of a claim paid by the United States to a lender which submitted such claim to the United States as a result of a foreclosure conducted in the State of Wisconsin, in which the lender elected and was permitted to waive deficiency and accelerate the redemption period pursuant to Wis. Stats. sec. 846.101 (1989), but excluding any claims based upon foreclosure of mortgages executed after December 31, 1989.

(Jan. 22, 1991 Decision and Order at 21.)

BACKGROUND

Wisconsin law controls the foreclosure procedures in this action. *See* 38 U.S.C. sec. 3720(a)(6). Pursuant to Wis. Stats. sec. 846.04, a lender may demand in a foreclosure complaint a judgment for deficiency following a foreclosure sale. When a foreclosure is sought under this statute, the debtor is given a twelve-month redemption period. Wis. Stats. sec. 846.10. Pursuant to Wis. Stats. sec. 846.101, a lender may waive judgment for deficiency in a foreclosure complaint. When a foreclosure is sought under this statute, the debtor is given a six-month redemption period.[1] All the lenders in this action foreclosed pursuant to sec. 846.101, thereby waiving the right to a deficiency judgment.

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[1] The VA may also permit a lender to accept a voluntary deed in lieu of foreclosure, whereby the lender receives the property's title and the veteran's personal liability is released. Prior to 1983, a lender could also foreclose by advertisement.

When the VA guarantees a loan, it must reimburse the lender for any losses when a veteran defaults. *See* 38 C.F.R. sec. 36.4321. The lenders in this action received reimbursements from the VA for deficiencies remaining after foreclosure.

On January 22, 1991, this court enjoined the VA from collection on its indemnification claims and ordered the VA to refund money it had previously collected for indemnification.[2] On April 3, 1992, the Seventh Circuit reversed the injunction, holding that the VA has a right to indemnification for guaranties paid to lenders which had foreclosed pursuant to sec. 846.101.

This action was remanded to determine which class members are relieved of liability based on *United States v. Church*, 736 F. Supp. 1494 (N.D. Ind. 1990). The court in

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[2] The VA does not seek reimbursement from defaulting vets for loans closed after December 31, 1989. (Sept. 9, 1992 Bitters Aff. P 4.)

Church held that when lenders do not follow the VA's foreclosure instructions, any payments by the VA to these lenders are gratuitous and therefore do not entitle the VA to indemnification. This court's task, therefore, is to determine what foreclosure instructions were given by the VA, and which lenders did and did not follow these instructions. Presently before the court are the parties' cross-motions for summary judgment.[3] On February 24, 1993, the court heard oral argument on the motions.

FACTS

The VA Acknowledgment Letter

The VA routinely sent a form acknowledgement letter to lenders after it was notified that a lender was planning to foreclose. All lenders in this action received this letter, which stated in part "in proceeding with such action, you should protect your rights against those liable, so as to protect our [the VA's] subrogated rights."[4] The parties have argued about what this means, but I think it's quite clear that it means that the lenders could not foreclose pursuant to sec. 846.101, which destroys the VA's subrogation rights with respect to obtaining a deficiency judgment. If this were the end of the inquiry, then it would follow that the VA's parents to the lenders were gratuitous, but the fact is that there was an additional course of dealing between the VA and the lenders.

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[3] Leonard H. Redinger, the defendant in Civil Action No. 90-C-1112, has not made an appearance. For purposes of finality, this court will include Redinger in the class's motion.

Course of Dealing

In the course of dealing between the VA and the lenders after 1983, the VA staff knowingly permitted Wisconsin lenders to foreclose pursuant to sec. 846.101, in order to reduce additional expenses which came with the longer redemption period than with foreclosures pursuant to sec. 846.04.

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[4] Examples of the letter are attached to the Sept. 9, 1992 Hurley Aff. at Ex. 1.

Tom Bitters, who has worked for the Wisconsin VA Office of District Counsel since 1968, and has been involved in loan guaranty matters since 1975, states that after the provisions for foreclosure by advertisement were repealed in November 1983, most of the Wisconsin lenders foreclosed pursuant to sec. 846.101. (Sept. 9, 1992 Bitters Aff. P 3; *see also* Sept. 2, 1992 Childs Aff.[5] P 3.) Between Oct. 1985 and April 1989, 1170 loans were foreclosed pursuant to sec. 846.101, 442 voluntary deeds in lieu of foreclosure were accepted, and there were no foreclosures pursuant sec. 846.04. (Sept. 9, 1992 Hurley Aff. [6] P 7.) Bitters does not know of any time when the VA has instructed a lender to seek a deficiency judgment. (Bitters Aff. P 5; *see also* Hurley Aff. P 5: "It has never been the policy of the Loan Guaranty Division to instruct lenders to effect foreclosure pursuant to Wis. Stats. secs. 846.04 & 846.10 and take deficiency judgments"; Sept. 4, 1992 Wojculis Aff.[7] P 2: recalls no instruction to foreclose pursuant to sec. 846.04; Childs Aff. P 5: recalls only one instance of instructing a lender to foreclose pursuant to the twelve-month procedure.)

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[5] Childs began working in the Zablocki VA Loan Guaranty Division in 1967; she was the Chief of Loan Service & Claims from Jan. 1982 to Oct. 1988. She currently holds the same position in Denver.

[6] Hurley has worked in the Zablocki VA Regional Office Loan Guaranty Division since 1976.

Bitters has advised lenders that it was not necessary for them to foreclose pursuant to sec. 846.04 and seek a deficiency judgment, and that the VA preferred foreclosure pursuant to sec. 846.101. (Bitters Aff. P 5.) Additionally, because lenders were obligated to keep the VA informed of the pleadings in foreclosure actions pursuant to 38 C.F.R. sec. 36.4319(a), the VA knew that lenders were foreclosing pursuant to sec. 846.101.

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[7] Wojculis has worked in the Zablocki VA Loan Guaranty Division since 1978. Since 1981, she has been a Loan Service Representative.

Since 1980, the majority of VA guaranteed loans in Wisconsin have been terminated by attorneys Terry Gray, Robert Johnson, and Robert Hersh. (Bitters Aff. P 15.) Gray was never instructed by the VA to foreclose in any particular manner, and has essentially used sec. 846.101 for the past nine years; he has never been instructed to take a deficiency judgment.[8] (Aug. 31, 1992 Gray Aff. P 3-5.) Johnson has never foreclosed pursuant sec. 846.04, and the VA has never objected. (Sept. 1, 1992 Johnson Aff. P 3.) Hersh has always instructed lenders to foreclose pursuant to sec. 846.101, and he understood that the VA had no objection; Bitters advised him that there was no necessity to take a deficiency judgment to preserve the VA's indemnification rights. (Aug. 31, 1992 Hersh Aff. PP 2-3.)

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[8] Gray sent Bitters a letter dated July 29, 1986 which stated "unless you instruct us to the contrary on a specific case, we will waive your right to a deficiency judgment against the defendants in order to obtain the shortest possible redemption period under Wisconsin law. As you know, the VA and the FHA do not object to such a waiver in Wisconsin. " (Aug. 31, 1992 Gray Aff., Ex. 1.)

The Relationship Between the VA and the Veterans

The veterans knew that any foreclosure proceedings would be brought pursuant to sec. 846.101. Paragraph 18 of the VA's mortgage form states "The Mortgagor [the veteran] agrees that in the event of foreclosure of this mortgage he will be bound by the provisions of Section 846.101 of the Wisconsin statutes. " (Bitters Aff., Ex. 11.) Second, the application for a home loan guaranty, signed by the veteran, states that ". . . you will not be relieved from liability to repay any guaranty claim which the VA may be required to pay your lender on account of default in your loan payments. The amount of any such claim payment will be a debt owed by you to the Federal Government." (Ex. 200, admitted at oral argument.) And, third, the VA routinely notified the veterans that even though the lender may not hold the veteran liable for a deficiency, the veteran may be liable to the VA for any money it pays regarding the loan guarantee. (Bitters Aff. P 11, Ex. 13.)

ANALYSIS

The factual record on summary judgment consists only of sworn testimony based upon personal knowledge; conclusory allegations, whether contained in pleadings or set forth in affidavits, are excluded. Fed. R. Civ. P. 56(e); Fed. R. Evid. 602; *Koclanakis v. Merrimack Mut. Fire Ins. Co.*, 899 F.2d 673, 675 (7th Cir. 1990). The parties have filed cross-motions for summary judgment thereby agreeing that the issue of whether the lenders followed the VA's instructions may be resolved at this stage of the proceedings. This court must initially determine what those instructions were. The instructions are contained in a written acknowledgment letter and in the course of dealing between the VA and the lenders.

Given the above set of facts, it appears that on the one hand the VA habitually sent out the acknowledgement letter but on the other hand engaged in a course of conduct in which it knew and acquiesced, if not verbally directed, the lenders to foreclose pursuant to sec. 846.101. It is true that the VA did not specifically "direct" the lenders in writing to foreclose pursuant to sec. 846.101, which the class argues is required by 38 C.F.R. sec. 36.4324(f):

> The release of the personal liability of any obligor [i.e., veteran] on a guaranteed or insured obligation resultant from the act or omission of any holder [lender] without the prior *approval* of the Secretary shall release the obligation of the Secretary as guarantor or insurer, except when such act or omission consists of . . . an election and appropriate prosecution of legally available effective remedies with respect to the repossession or the liquidation of the security in any case, irrespective of the identity or the survival of the original or of any subsequent debtor, if holder [lender] shall have given such notice as required by sec. 36.4317[9] of this part and if, after receiving such notice, the secretary shall have failed to notify the holder within 15 days[10] to proceed in such manner as to

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[9] Pursuant to 38 C.F.R. sec. 36.4317, a lender must give the VA thirty days notice of its intent to foreclose.

[10] The VA's instruction is timely as long as the lender receives notice before the lender has released the debtor. *Western Securities Co. v. Derwinski*, 937 F.2d 1276, 1281-1282 (7th Cir. 1991). In Wisconsin, the debtor is not released until the foreclosure action is commenced. *See*

> effectively preserve the personal liability of the parties liable. . . .

(emphasis added.)

The VA, however, not only knew that the lenders were foreclosing pursuant to sec. 846.101, but encouraged them to do so. Not only did the VA verbally instruct lenders to foreclose pursuant to sec. 846.101, but the VA provided mortgage forms to the lenders which state in paragraph 18 that "the Mortgagor [the veteran] agrees that in the event of foreclosure of this mortgage he will be bound by the provisions of Section 846.101 of the Wisconsin statutes." (Bitters Aff., Ex. 11.) The class does not cite any relevant authority regarding why this understanding between the VA and the lenders does not constitute "approval of the Secretary."

Wis. Stats. sec. 846.101(1).

Effect of the Church Decision

In *Church*, the same letter was sent out that was used in this case. However, the *Church* court does not discuss or even mention this letter. Additionally, the court did not consider the course of dealing that is before this court. Further, the *Church* court states that after the VA accepted a forbearance agreement which averted the foreclosure, the VA "renewed its demand to preserve Church's personal liability if foreclosure became necessary." *Id*. at 1496. And, "the Wisconsin VA [the lender] chose not to pursue a deficiency judgment after the VA had requested that it do so." *Id*. at 1499. The *Church* court did not unequivocally hold that the form letter alone was an instruction which the lender did not follow, thereby releasing the VA from any liability to make payments for a deficiency following foreclosure.

Church, therefore, does not direct this court to conclude that the payments from the VA to the lenders in this action were gratuitous. This court finds that the lenders followed the VA's foreclosure instructions. The VA therefore has a right to indemnification for the guaranties it paid to the lenders.

IT IS THEREFORE ORDERED that the Third-Party Plaintiff's August 11, 1992 motion for summary judgment is DENIED.

IT IS FURTHER ORDERED that plaintiff United States of America and Third-Party Defendant Jesse Brown's September 10, 1992 motion for summary judgment is GRANTED.

IT IS FURTHER ORDERED that on or before twenty days from the date of this order, plaintiff United States of America shall file and serve a memorandum and any necessary supporting affidavits regarding the amount of judgment to be entered against defendants Charles Davis and Leonard H. Redinger.

IT IS FURTHER ORDERED that on or before twenty days from receipt of plaintiff's memorandum, defendants Charles Davis and Leonard H. Redinger shall file and serve a response.

Dated at Milwaukee, Wisconsin, this 17th day of March, 1993.

BY THE COURT: John W. Reynolds, Senior Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA,
Plaintiff,

v. Civil Action No. 90-C-0067
consolidated with
CHARLES DAVIS, Civil Action No. 90-C-1112
Defendant.

and

CHARLES DAVIS, individually
and on behalf of all others
similarly situated,
Third-Party Plaintiff,

v.

JESSE BROWN,
Secretary of Veterans Affairs,
Third-Party Defendant.

and

UNITED STATES OF AMERICA,
Plaintiff,

v.

LEONARD H. REDINGER,
Defendant.

ORDER

This class action involves veterans whose loans were guaranteed by the Veterans Administration[1] pursuant to a home loan guaranty program. On March 17, 1993, this court granted plaintiff United States of America and third-party defendant Jesse Brown's (collectively, the government") motion for summary judgment, concluding that the government has a right to indemnification from the veterans for the guaranties it paid to lenders. This court reserved entering judgment pending briefing on a remaining issue in this action.

Before the court is the government's April 6, 1993 motion for entry of judgment against defendants Charles Davis and Leonard H. Redinger, and for entry of judgment dismissing the third-party action.

Davis, individually and as class representative, objects to the government's motion to enter judgment against defendant Redinger, arguing that the original action naming Redinger as a defendant should be dismissed without prejudice.[2] The government does not oppose such dismissal.

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[1] Now known as the United States Department of Veterans Affairs.

IT IS THEREFORE ORDERED that Civil Action Number 90-C-1112 is DISMISSED WITHOUT PREJUDICE.

IT IS FURTHER ORDERED that judgment be entered dismissing the third-party plaintiff's action in accordance with this court's March 17, 1993 order.

IT IS FURTHER ORDERED that judgment be entered against defendant Charles Davis for a principal amount of $21,393.61, plus interest accruing at an annual rate of four percent from March 2, 1987, until defendant Charles Davis' debt to the United States Department of Veterans Affairs is fully repaid.

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[2] Leonard H. Redinger, the defendant in Civil Action No. 90-C-1112, has not made an appearance.

Dated at Milwaukee, Wisconsin, this 16 day of June, 1993.

BY THE COURT

/s/

John W. Reynolds
Senior Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA,
Plaintiff,

v. Civil Action No. 90-C-0067

CHARLES DAVIS,
Defendant.

and

CHARLES DAVIS, individually
and on behalf of all others
similarly situated,
Third-Party Plaintiff,

v.

JESSE BROWN
Secretary of Veterans Affairs,
Third-Party Defendant.

ORDER

Presently before the court is third-party plaintiff's June 30, 1993 motion to alter or amend this court's June 16, 1993 judgment. The judgment denied third-party plaintiff's motion for summary judgment, and granted plaintiff and third-party defendant's motion for summary judgment.

Because no arguments are presented which were not previously considered by this court, the motion will be denied.

IT IS THEREFORE ORDERED that third-party plaintiff's June 30, 1993 motion to alter or amend judgment is DENIED.

Dated at Milwaukee, Wisconsin, this 28th day of July, 1993.

BY THE COURT

/s/

John W. Reynolds
Senior Judge

United States Court of Appeals
For the Seventh Circuit
Chicago, Illinois 60604

October 3, 1994.

Before

Hon. RICHARD D. CUDAHY, Circuit Judge

Hon. JESSE E. ESCHBACH, Circuit Judge

Hon. MICHAEL S. KANNE, Circuit Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellee,) Appeal from the
) United States District
No. 93-3104 v.) Court for the Eastern
CHARLES DAVIS,) District of Wisconsin.
Defendant/Third-Party Plaintiff-) No. 90-C-0067,
Appellant,) John W. Reynolds,
JESSE BROWN, Secretary of) Judge.
veterand Affairs,
Third-Party Defendant-Appellee.

O R D E R

On consideration of the petition of appellant, Charles Davis, Defendant/Third-Party Plaintiff, labeled as "Appellant's Petition For Rehearing" but in text suggesting

Rehearing In Banc, no judge in active service has requested a vote thereon and all of the judges on the original panel have voted to deny the petition. Accordingly,

IT IS ORDERED that the aforesaid petition be and the same is hereby, DENIED.

May 3, 1985

Anchor Mortgage
2060 Algonquin Rd., Suite 608
Schaumburg, IL 60195

330/265
LH 171 389 WI
AM 698 66 306125304
DAVIS, Charles

Gentlemen:

We have received your notice of intent to foreclose.

The borrower advised us his income falls short of his expenses. He is trying to sell the house. If funds are tendered to your satisfaction, we recommend acceptance and reinstatement of the account.

Should foreclosure be the only recourse, we will not object to action being taken after May 15, 1985.

In proceeding with such action, you should protect your rights against those liable, so as to protect our subrogated rights. The Administrator of Veterans Affairs does not desire to be made a party to the proceedings, but copies of all procedural papers should be forwarded to us within such time as would be required if the Administrator were a party.

Sincerely yours,

DIANE WOJCULIS
Loan Service Representative

October 8, 1982

Marine First National Bank
P.O. Box 680
Janesville, WI 53547

330/265
CHURCH, Scott
WDVA#: RA 129-61903
LH 173314 WI

Gentlemen:

We have received your notice of intention to foreclose.

We have contacted and discussed the default with Mr. Church. The reason for the delinquency is due to Mr. Church being laid-off and not receiving any income. He is looking for work and trying to borrow funds needed to reinstate the account. If funds are tendered to your satisfaction, we would recommend acceptance of the funds and reinstatement of the account. Such action will not jeopardize the guaranty.

If foreclosure becomes the only recourse, we will not object to action being taken after September 26, 1982, which was 30 days after receiving your notice.

In proceeding with such action, you should protect your rights against those liable , so as to protect our subrogated rights. The Administrator of Veterans Affairs does not desire to be made a party to the proceedings, but copies of all procedural papers should be forwarded to us within such time as would be required if the Administrator were a party.

Sincerely,

GARY HANSON
Loan Service Representative

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

Article 1, Sec. 9, Clause 7 of the United States Constitution provides:

> No money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

38 U.S.C. sec. 501(a) provides:

> The Secretary has authority to prescribe all rules and regulations which are necessary or appropriate to carry out the laws administered by the Department and are consistent with those laws, including --
>
> (1) regulations with respect to the nature and extent of proof and evidence and

the method of taking and furnishing them in order to establish the right to benefits under such laws;

(2) the forms of application by claimants under such laws;

(3) the methods of making investigations and medical examinations; and

(4) the manner and form of adjudications and awards.

38 C.F.R. sec. 36.4317 provides:

> Notice of intention to foreclose. Except upon the express waiver of the Secretary, a holder shall not begin proceedings in court or give notice of sale under power of sale, or otherwise take steps to terminate the debtor's rights in the security until the expiration of 30 days after delivery by registered mail to the

Secretary of a notice of intention to take such action: Provided, that

(a) Immediate action as required under 38 CFR 36.4346(i), may be taken if the property to be affected thereby has been abandoned by the debtor or has been or may be otherwise subjected to extraordinary waste or hazard, or if there exist conditions justifying the appointment of a receiver for the property (without reference to any contractual provisions for such appointment);

(b) Any right of a holder to repossess personal property may be exercised without prior notice to the Secretary; but notice of any such action taken shall be given by certified mail to the

Secretary within ten days thereafter; and

(c) The notice required under this paragraph shall also be provided to the original veteran-borrower and any other liable obligors by certified mail within 30 days after such notice is provided to the Secretary in all cases in which the current owner of the property is not the original veteran-borrower. A failure by the holder to make a good faith effort to comply with the provisions of this subparagraph may result in a partial or total loss of guaranty or insurance pursuant to VA Regulation 36.4325(b), but such failure shall not constitute a defense to any legal action to terminate the loan. A good faith effort will include, but is not limited to:

(1) A search of the holder's automated and physical loan record systems to identify the name and current or last known address of the original veteran and any other liable obligors;

(2) A search of the holder's automated and physical loan record systems to identify sufficient information (e.g., Social Security Number) to perform a routine trace inquiry through a major consumer credit bureau;

(3) Conducting the trace inquiry using an in-house credit reporting terminal;

(4) Obtaining the results of the inquiry;

(5) Mailing the required notices and concurrently providing the Secretary with the names and addresses of all obligors identified and sent notice; and,

(6) Documentation of the holder's records.

38 C.F.R. sec. 36.4323(e)(first sentence) provides:

> Any amounts paid by the Secretary on account of the liabilities of any veteran guaranteed or insured under the provisions of 38 U.S.C. chapter 37 shall constitute a debt owing to the United States by such veteran.

38 C.F.R. sec. 36.4324(f)(2) provides:

> The release of the personal liability of any obligor on a guaranteed or insured obligation resultant from the act or omission of any

holder without the prior approval of the Secretary shall release the obligation of the Secretary as guarantor or insurer, except when such act or omission consists of . . . (2) an election and appropriate prosecution of legally available effective remedies with respect to the repossession or the liquidation of the security in any case, irrespective of the identity or the survival of the original or of any subsequent debtor, if holder shall have given such notice as required by sec. 36.4317 of this part and if, after receiving such notice, the Secretary shall have failed to notify the holder within 15 days to proceed in such manner as to effectively preserve the personal liability of the parties liable, or such of them as the Secretary indicates in such notice to the holder . . .

Sec. 846.04, Wis. Stats., provides:

> The plaintiff may in his complaint demand judgment for any deficiency which may remain due to him after sale of the mortgaged premises against every party who is personally liable for the debt secured by the mortgage and judgment for any such deficiency remaining after applying the proceeds of sale to the amount due may in such case be rendered. Such judgment for deficiency shall be ordered in the original judgment and separately rendered against the party liable on or after the coming in and confirmation of the report of sale, and be docketed and enforced as in other cases.

Sec. 846.10, Wis. Stats., provides:

Foreclosure.

(1) If the plaintiff recovers the judgment shall describe the mortgaged premises and fix the amount of the mortgage debt then due and also the amount of each instalment thereafter to become due, and the time when it will become due, and whether the mortgaged premises can be sold in parcels and whether any part thereof is a homestead, and shall adjudge that the mortgaged premises be sold for the payment of the amount then due and of all instalments which shall become due before the sale, or so much thereof as may be sold separately without material injury to the parties interest-

ed, and be sufficient to pay such principal, interest and costs; and when demanded in the complaint, direct that judgment shall be rendered for any deficiency against the parties personally liable and, if the sale is to be referee, he must be named therein.

(2) Any party may become a purchaser. No sale involving a one- to 4-family residence that is owner-occupied at the commencement of the foreclosure action, a farm, a church or a tax-exempt nonprofit charitable organization may be held until the expiration of 12 months from the date when judgment is entered, except a sale under s. 846.101 or 846.102. Notice of the time and place of sale shall be given

under ss. 815.31 and 846.16 and may be given within the 12-month period except that the first printing of the notice shall not be made less than 10 months after the date when judgment is entered, except that the sale of a farm shall not be made or advertised until the expiration of one year from the date when such judgment is entered. In all cases the parties may, by stipulation, filed with the clerk, consent to an earlier sale. Sales under foreclosure of mortgages given by any railroad corporation may be made immediately after the rendition of the judgment.

(3) The proceeds of every sale shall be applied to the discharge of the debt

adjudged to be due and the costs awarded; and if there shall be any surplus it shall be subject to the order of the court. If any surplus remains in the court for three months, without being applied for, the court shall direct the same to be put out at interest for the benefit of the party entitled thereto to be paid to him upon the order of such court.

(4) The court may order in the judgment of foreclosure that all sums advanced by the plaintiff for insurance, necessary repairs and taxes not included in the judgment may be added to the judgment by order at any time after the entry thereof.

Sec. 846.101, Wis. Stats., provides:

> Foreclosure without deficiency; 20-acre parcels.
>
> (1) If the mortgagor has agreed in writing at the time of the execution of the mortgage to the provisions of this section, and the foreclosure action involves a one- to 4-family residence that is owner-occupied at the commencement of the action, a farm, a church or a tax-exempt charitable organization, the plaintiff in a foreclosure action of a mortgage on real estate of 20 acres or less, which mortgage is recorded subsequent to January 22, 1960, may elect by express allegation in the complaint to waive judgment for any deficiency which

may remain due to the plaintiff after sale of the mortgaged premises against every party who is personally liable for the debt secured by the mortgage, and to consent that the mortgagor, unless he or she abandons the property, may remain in possession of the mortgaged property and be entitled to all rents, issues and profits therefrom to the date of confirmation of the sale by the court.

(2) When plaintiff so elects, judgment shall be entered as provided in this chapter, except that no judgment for deficiency may be ordered therein nor separately rendered against any party who is personally liable for the debt secured by the mortgage and the sale

> of such mortgaged premises shall be made upon the expiration of 6 months from the date when such judgment is entered. Notice of the time and place of sale shall be given under ss. 815.31 and 846.16 within such 6-months period except that first printing of a copy of such notice in a newspaper shall not be made less than 4 months after the date when such judgment is entered.

Sec. 846.165, Wis. Stats., provides:

> Application for confirmation of sale and for deficiency judgment.
>
> (1) No sale on a judgment of mortgage foreclosure shall be confirmed unless 5 days' notice has been given to all

parties that have appeared in the action. Such notice shall be given either personally or by registered mail directed to the last-known post-office address, mailed at least 5 days prior to the date when the motion for confirmation is to be heard, if any post-office address is known; if not known, mailing may be dispensed with but an affidavit shall be filed with the court stating that the address is not known, and the notice shall state, in addition to other matter required by law, the amount of the judgment, the amount realized upon the sale, the amount for which personal judgment will be sought against the several parties naming them, and the time and place of hearing.

(2) In case the mortgaged premises sell for less than the amount due and to become due on the mortgage debt and costs of sale, there shall be no presumption that such premises sold for their fair value and no sale shall be confirmed and judgment for deficiency rendered, until the court is satisfied that the fair value of the premises sold has been credited on the mortgage debt, interest and costs.